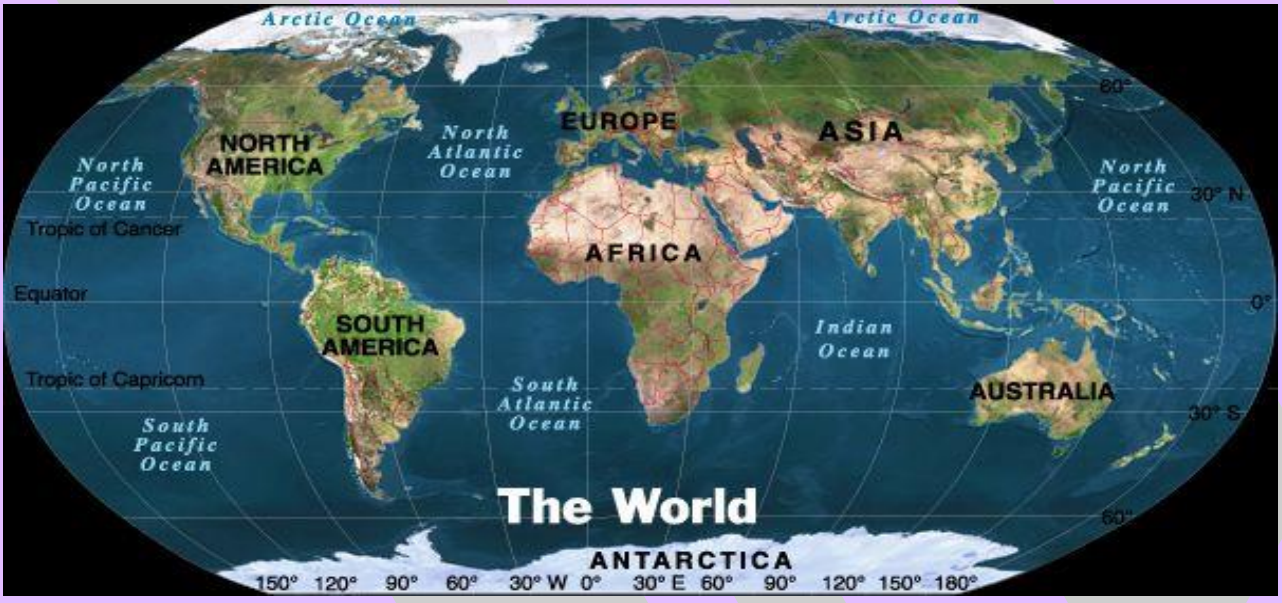
MGT. 205A



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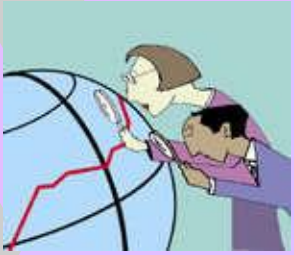
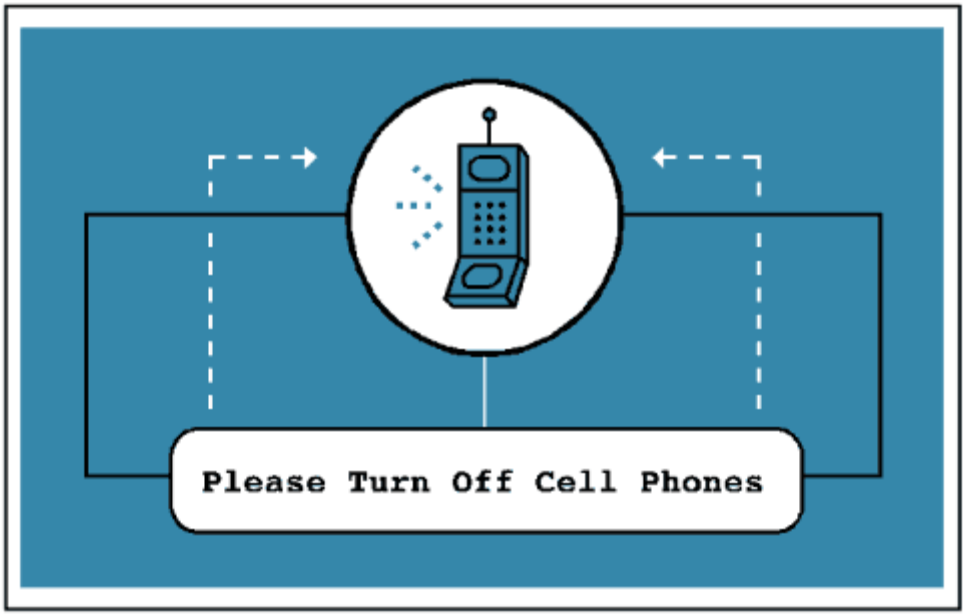
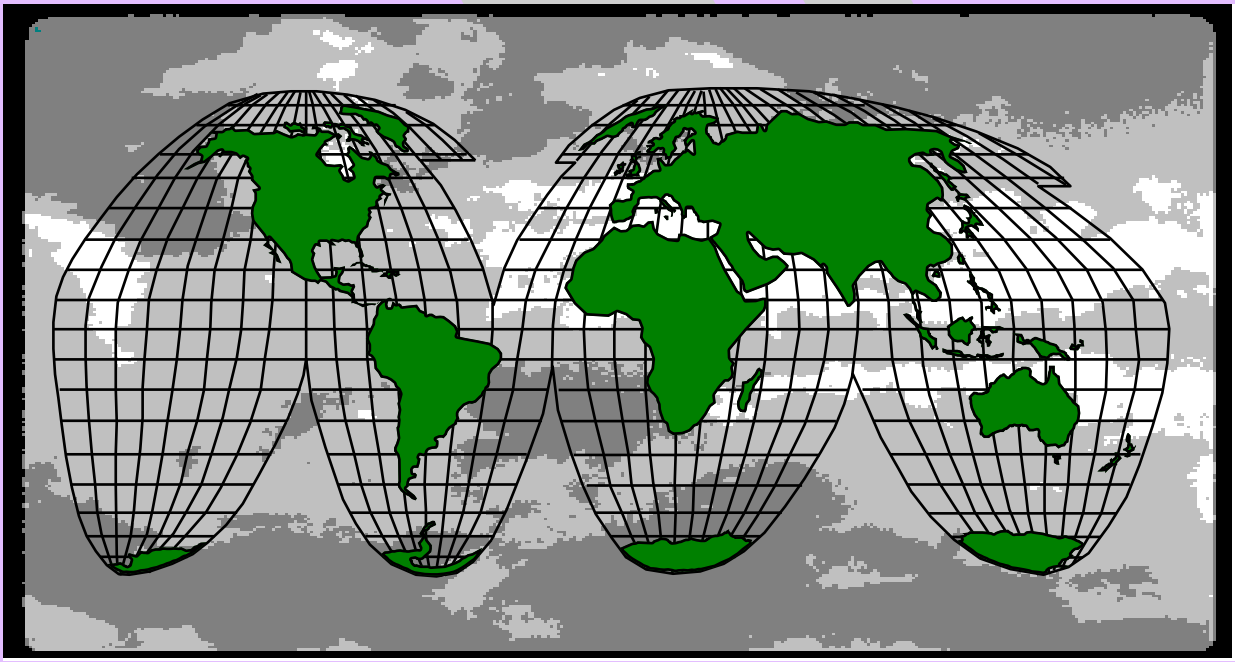


Reminder

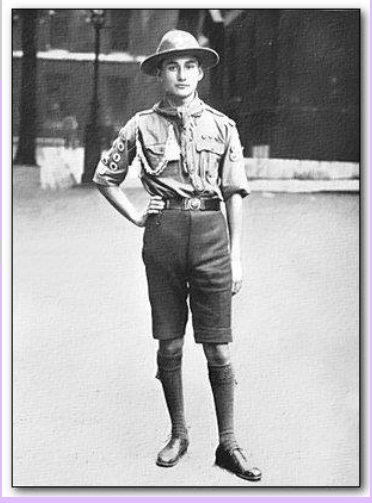


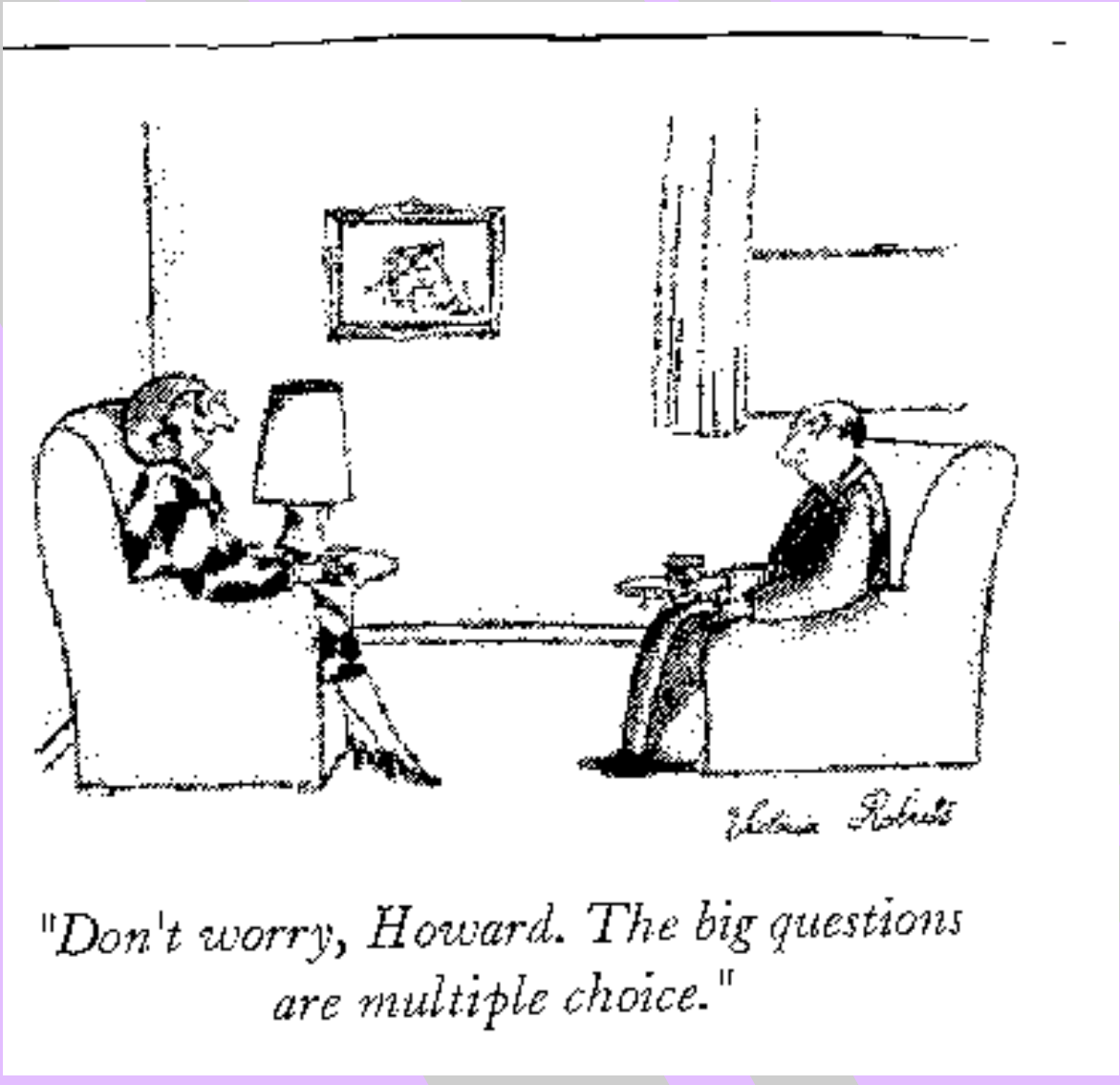


Midterm Exam
Coming Week 6

Don't panic

Be prepared





"Don't worry, Howard. The big questions are multiple choice."

Actually, exam is split between short answers such as multiple choice and longer problems

Preparing for Midterm Exam

- **Closed book 90-minute exam**
- **You can bring a hand calculator (but not necessary)**
- **Go over:**
  - **Your notes from class**
  - **Study Guide including sample questions and appendix list of concepts**
  - **Slides**
  - **Weekly summaries**
  - **Textbook**
- **Special Q&A Session**
  - **Optional**
  - **Monday, Week 6**
  - **Noon-1 PM, B413**
  - **Quaker meeting format**

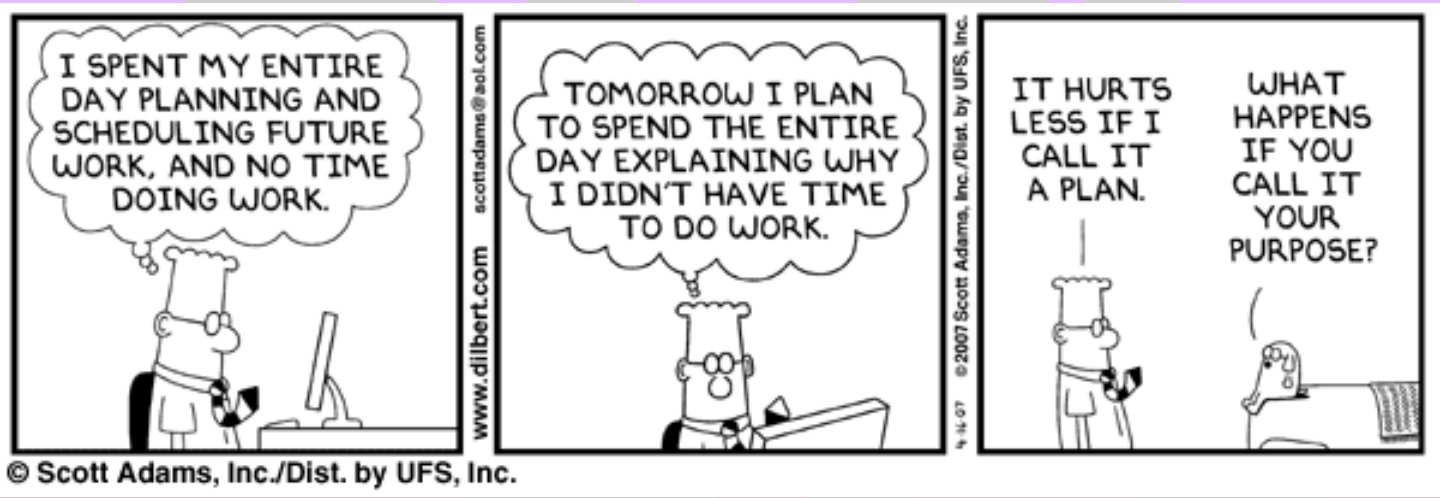
Q&A

No Q means no A

Not here...

… but in Room B413

Projects & Exams:
Effective time management


I SPENT MY ENTIRE DAY PLANNING AND SCHEDULING FUTURE WORK, AND NO TIME DOING WORK.
www.dilbert.com scottadams@aol.com
TOMORROW I PLAN TO SPEND THE ENTIRE DAY EXPLAINING WHY I DIDN'T HAVE TIME TO DO WORK.
© 2007 Scott Adams, Inc./Dist. by UFS, Inc.
IT HURTS LESS IF I CALL IT A PLAN.
WHAT HAPPENS IF YOU CALL IT YOUR PURPOSE?
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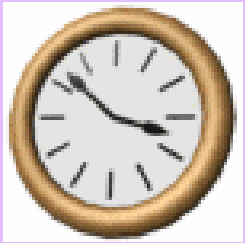
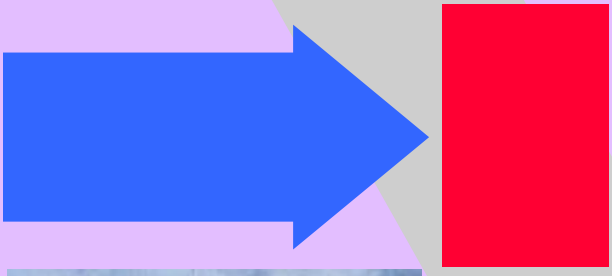


Outlines week 7
Projects week 9

Non-Tariff Barriers

(NTBs)

- **Evade the spirit**
- **Lower the lake**



- **Quotas**
- **Orderly marketing agreements**
- **Government purchasing**
- **Consumer protections rules**
- **Cultural protection rules**
- **Exchange controls**
- **Customs procedures**

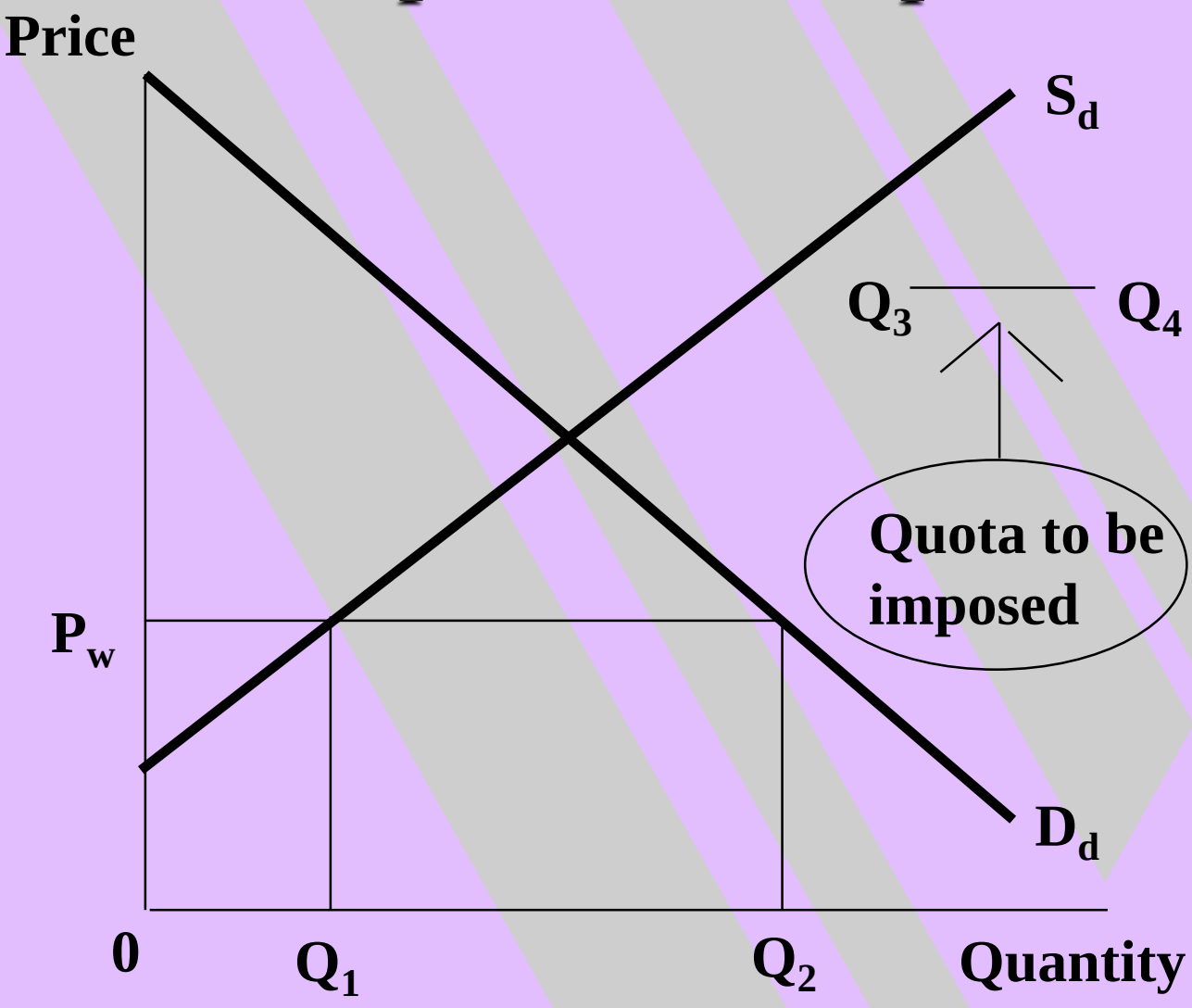
Quotas

- Competitive conditions
- Non-competitive conditions

Lessons for assessing domestic competition

Lessons for understanding requests for quota-like protection (rather than tariffs)

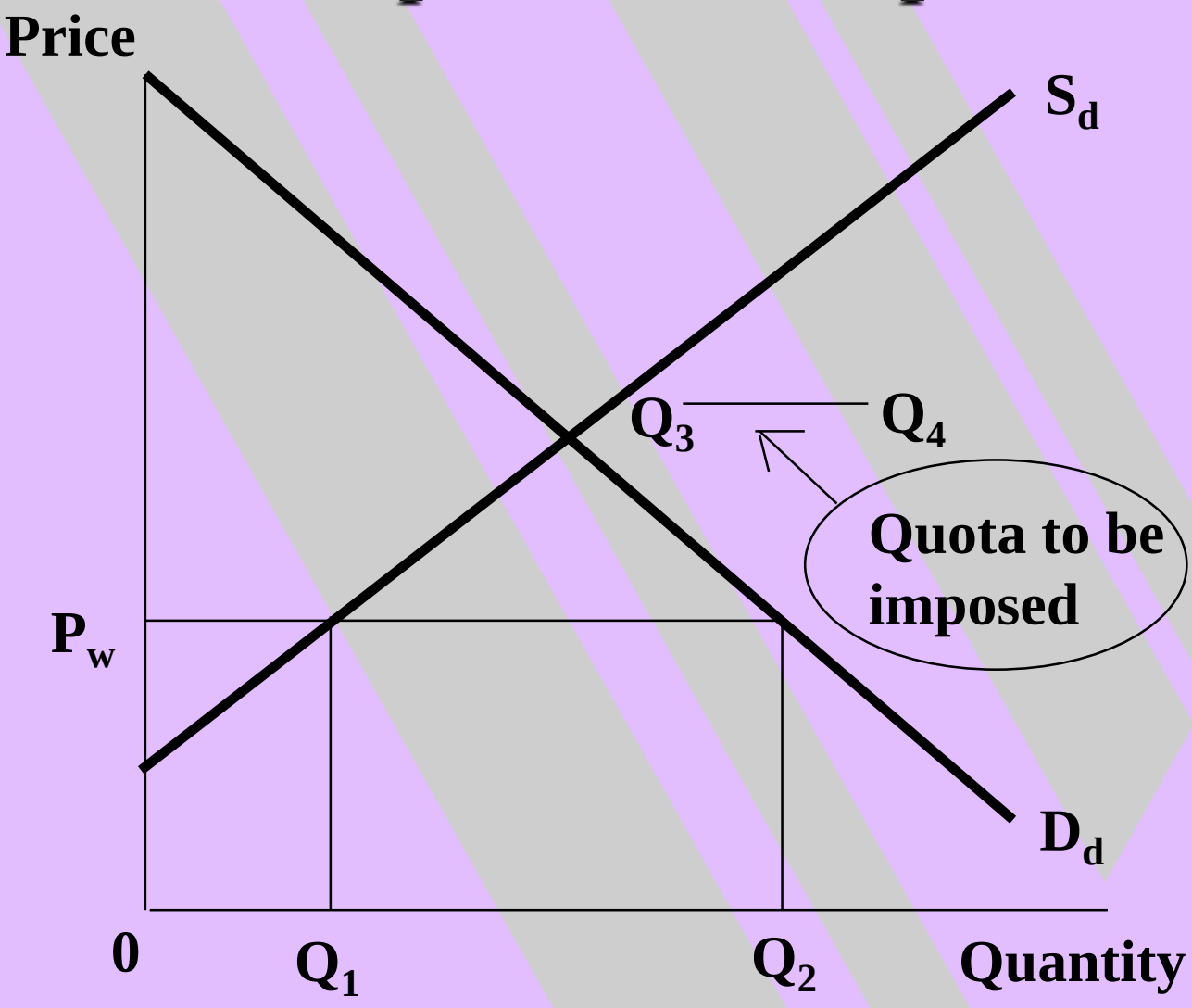
Non-Redundant Quota:
Competitive Example



<u>Question</u>: What will be impact of imposing quota $Q_3Q_4 < Q_1Q_2$ on price AND income distribution?

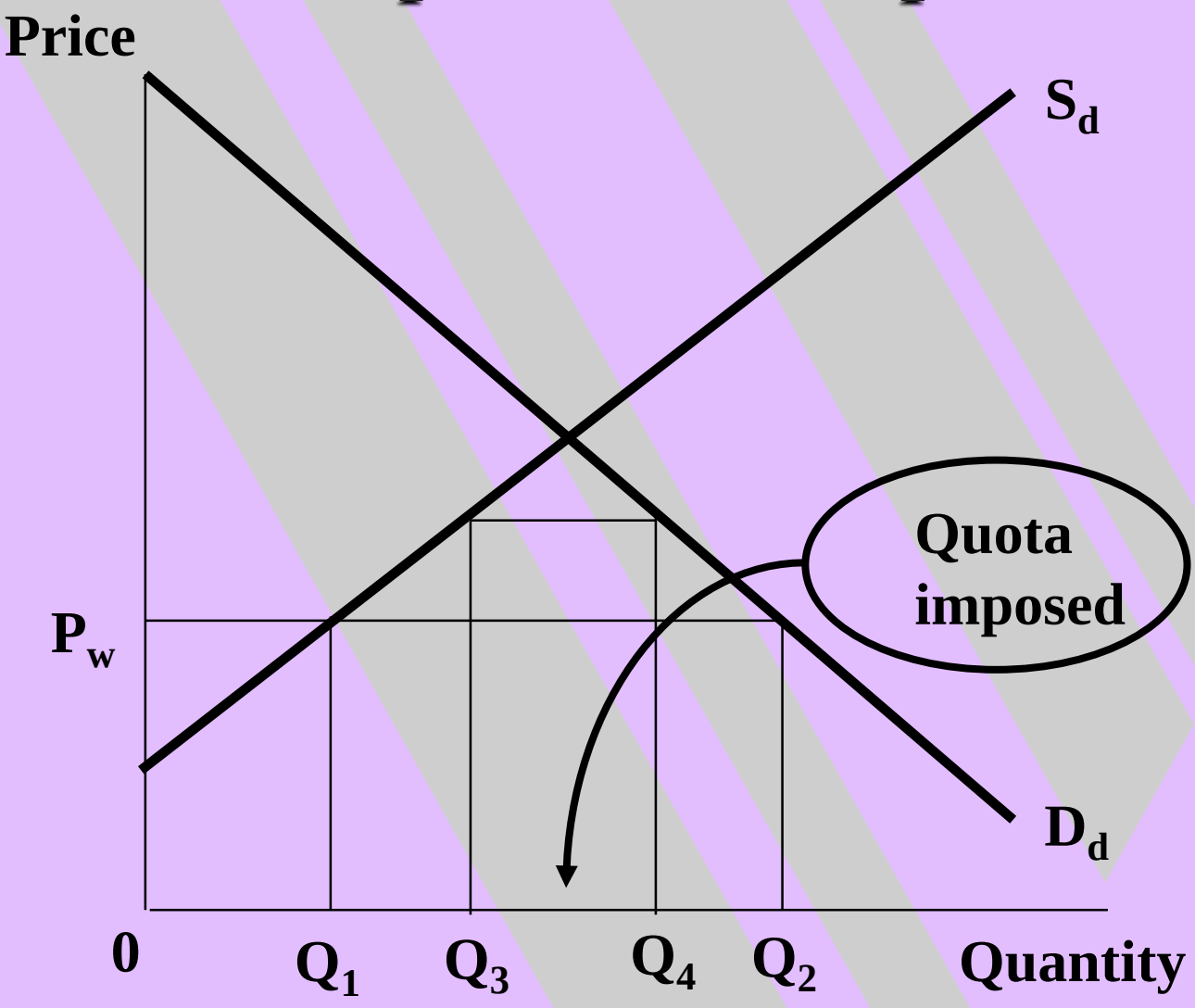
Non-Redundant Quota

Competitive Example

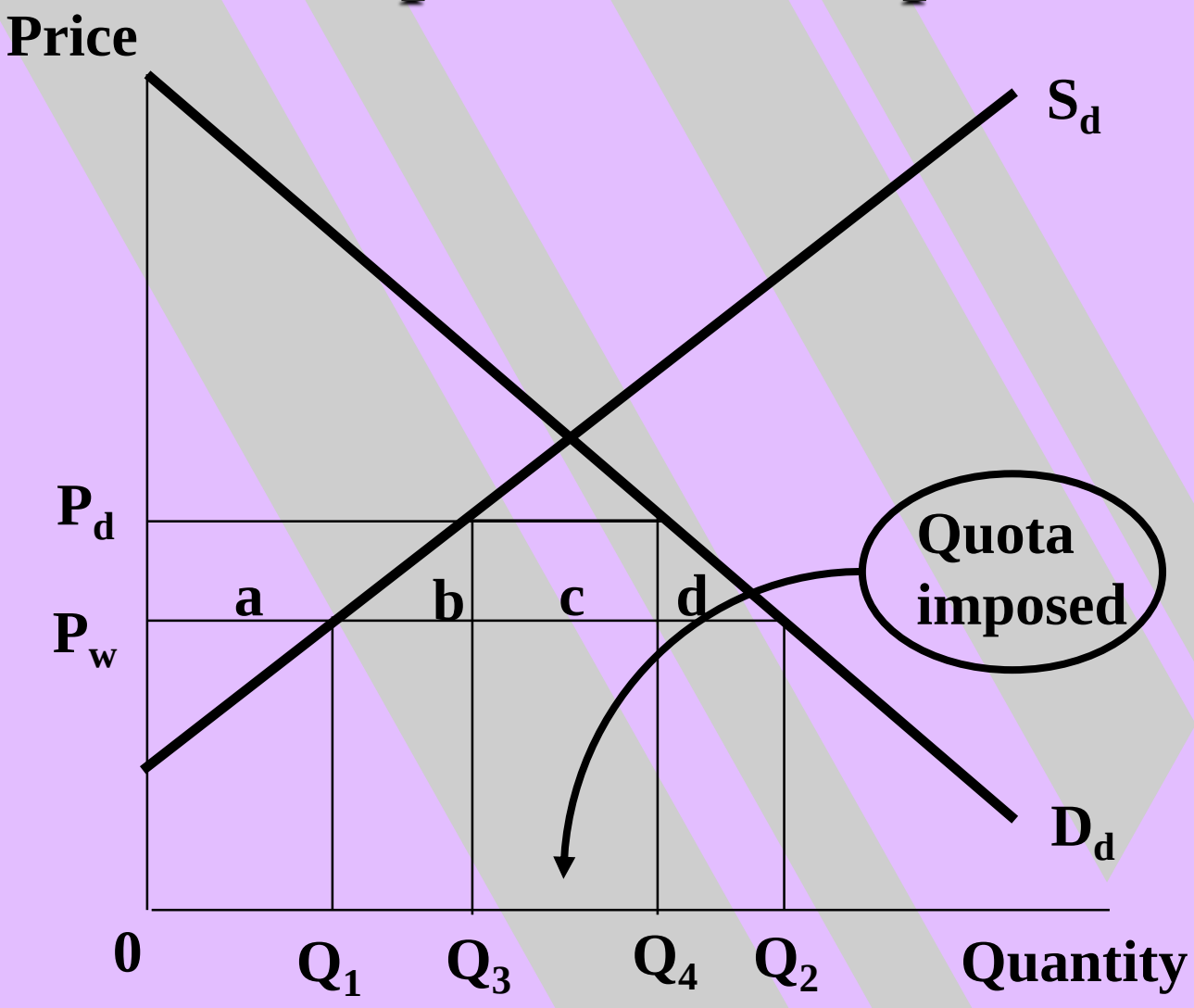


Non-Redundant Quota

Competitive Example



Non-Redundant Quota
Competitive Example



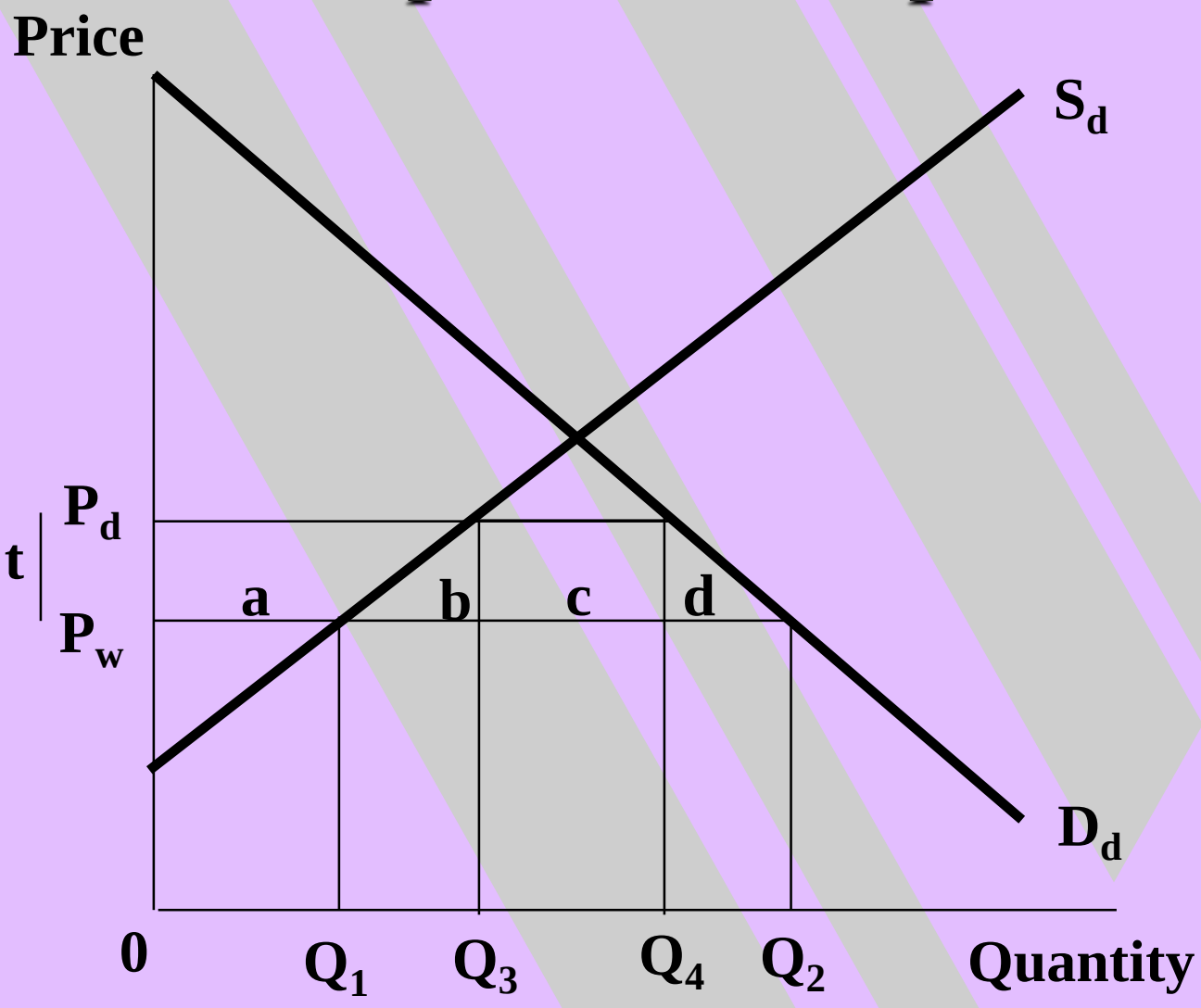
Question: What is a+b+c+d?

Question: What is "a"?

Question: What is (who gets) "c"?

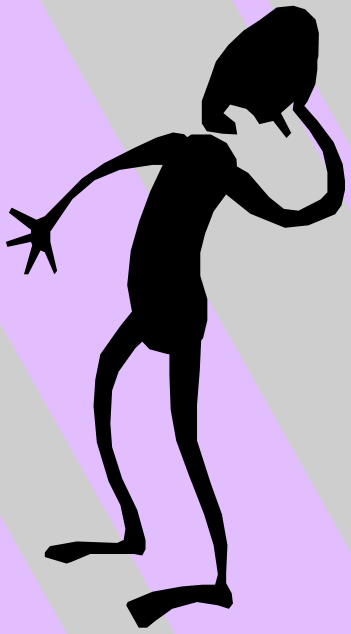
Non-Redundant Quota

Competitive Example



Question: What is relationship between quota Q_3Q_4 and tariff t?

Question: If D_d belonged to a monopolist and S_d = its marginal cost, what is impact of t?



Moral:

It’s no fun being a monopolist with tariff protection

(as compared with being a perfect competitor).

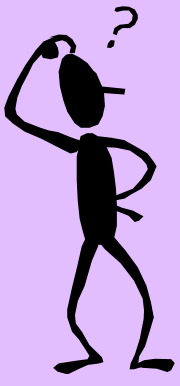
Another Moral:

Generally, a tariff leaves a connection between the world price and the domestic price.

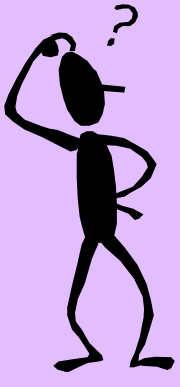
Generally, a quota cuts the connection between the world price and the domestic price.

Why is the word "generally" used above?

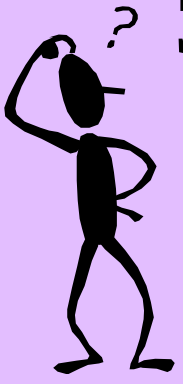
Three Questions



1) What do we learn about assessing the competitiveness of the domestic market when there is tariff-type protection?



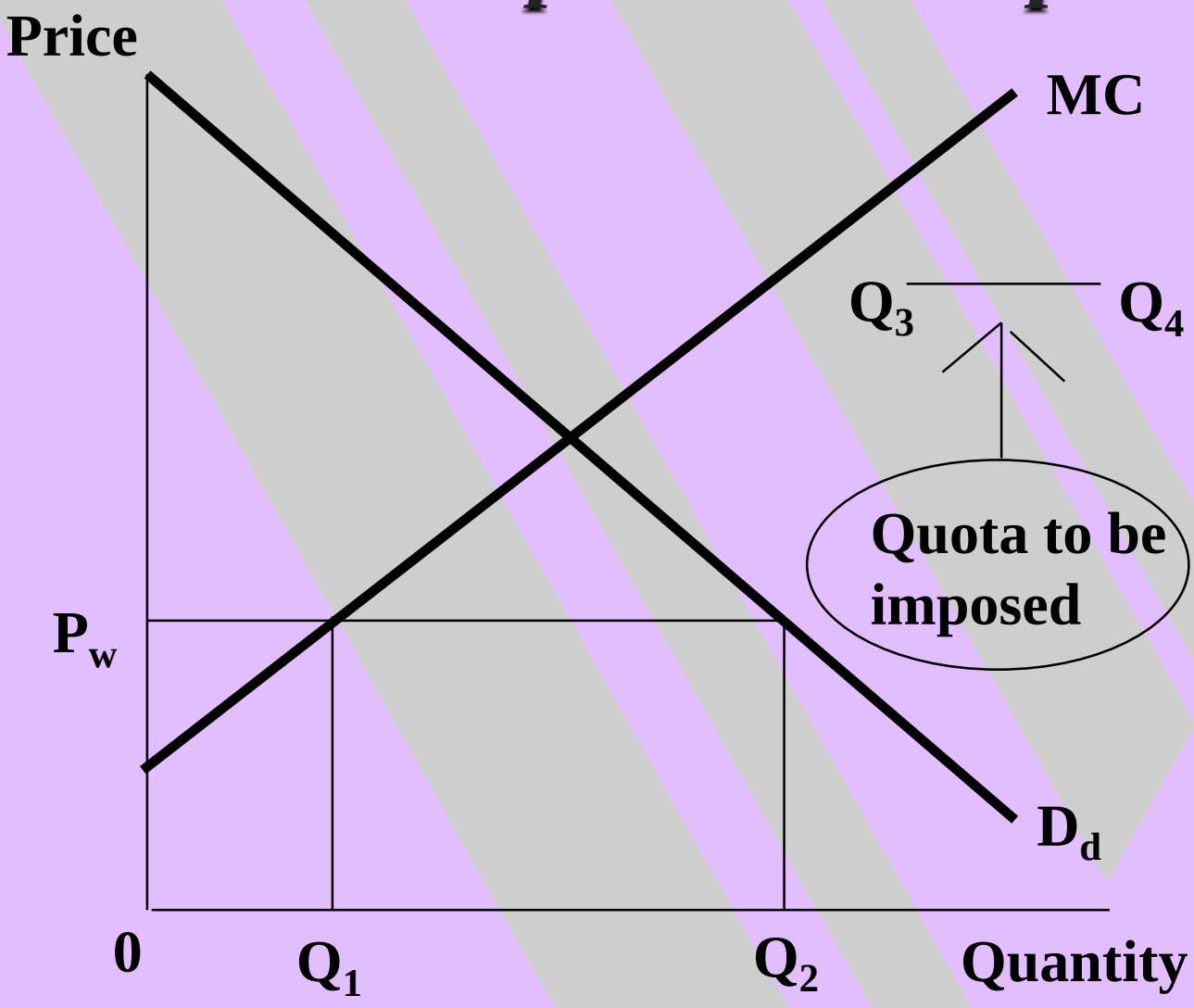
2) What do we learn about the willingness of exporting countries to go along with orderly marketing agreements?



3) Why might there be internal resistance to "tariffication"?

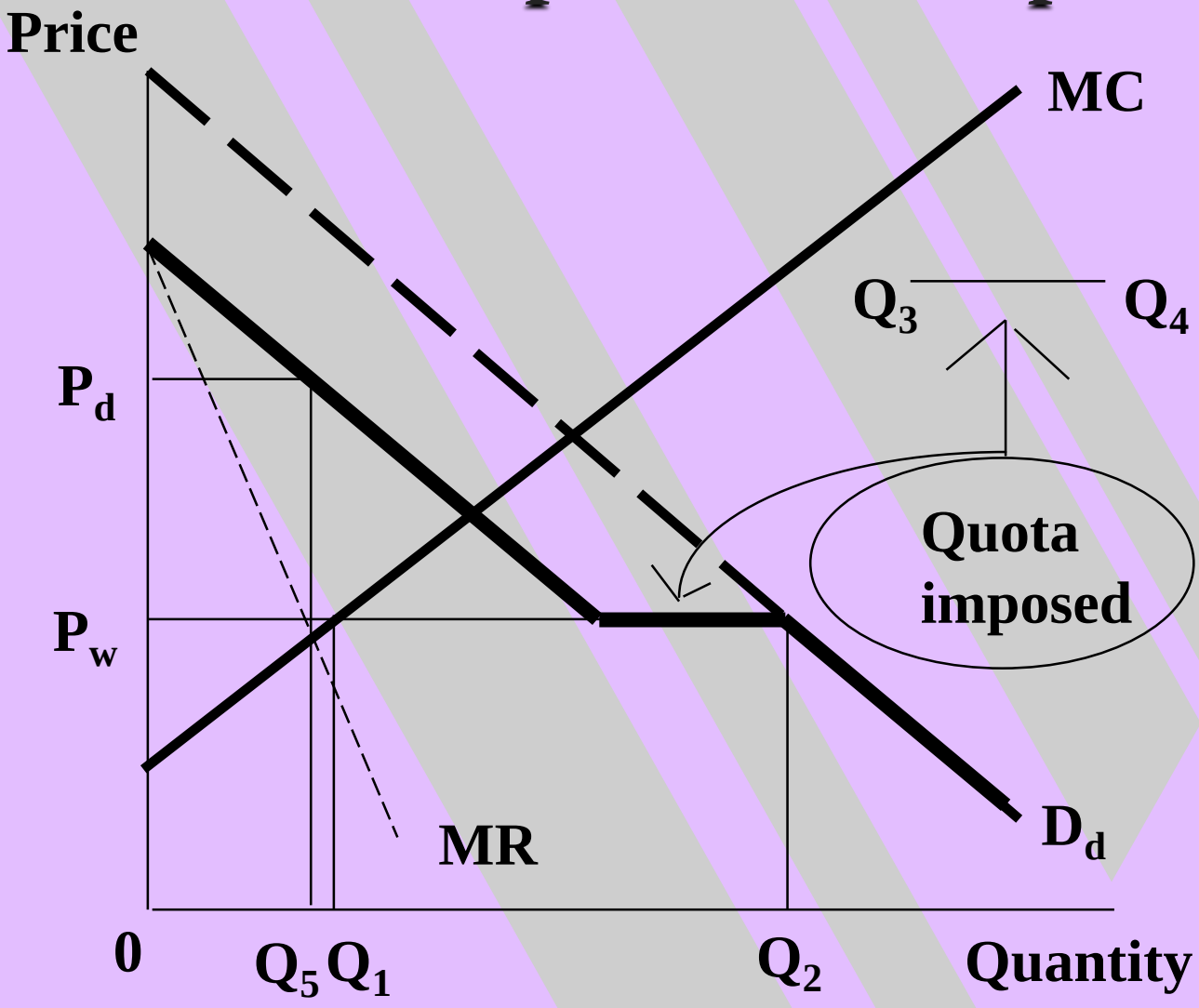
-

Non-Redundant Quota: Non-Competitive Example



Question: What will be impact of imposing quota $Q_3Q_4 < Q_1Q_2$ on price if demand curve D_d belongs to a monopolist and supply curve = marginal cost?

Non-Redundant Quota: Non-Competitive Example



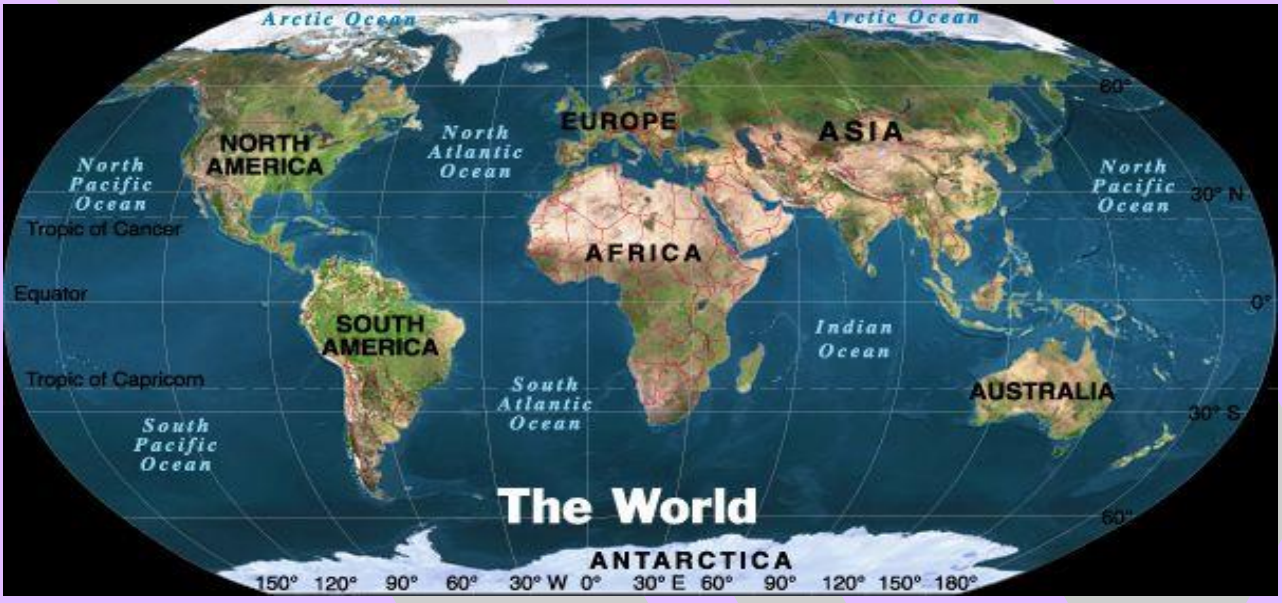
Profit-maximizing point is where MR = MC, i.e., at output = Q_5 and price = P_d.

<u>Question</u>: Why is there such a big difference between tariff and quota in this case?

Moral:

It’s more fun being a monopolist with a quota than with a tariff.

MGT. 205A



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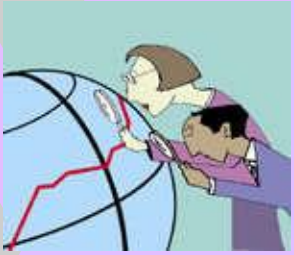
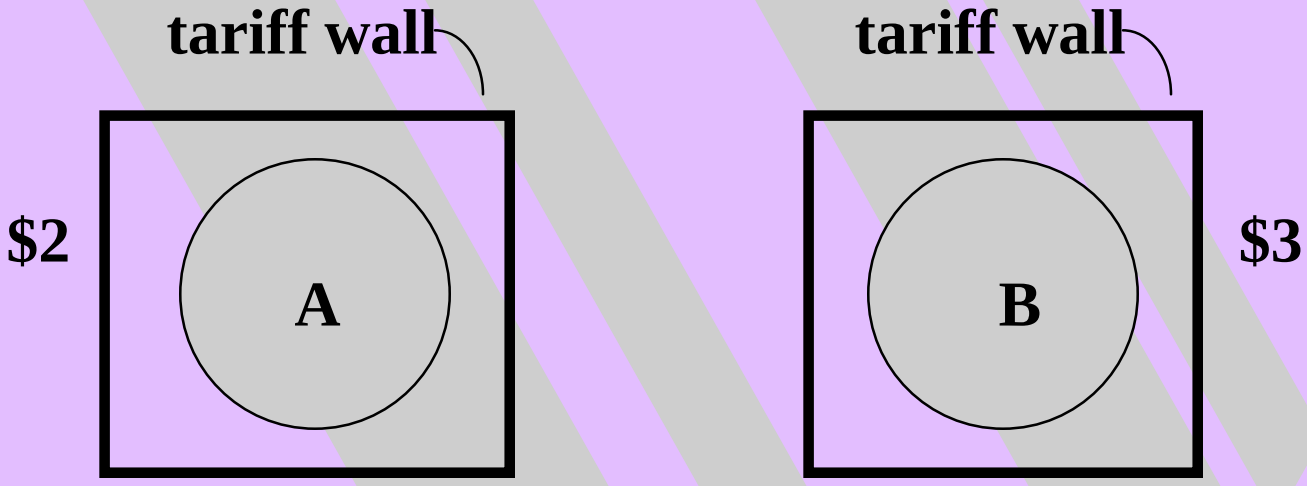


Trade Integration

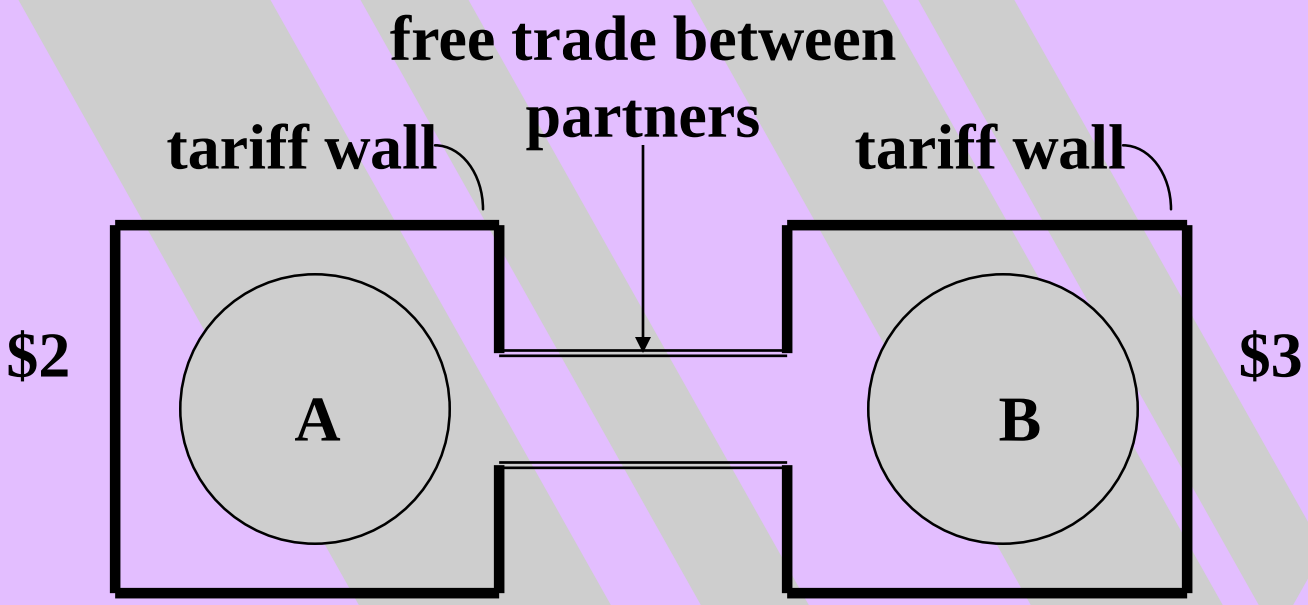
- Free trade areas
- Customs unions
- Common markets
- Partial agreements
- Issues:
  - Customs administration
  - Trade creation vs. trade diversion

Free Trade Area



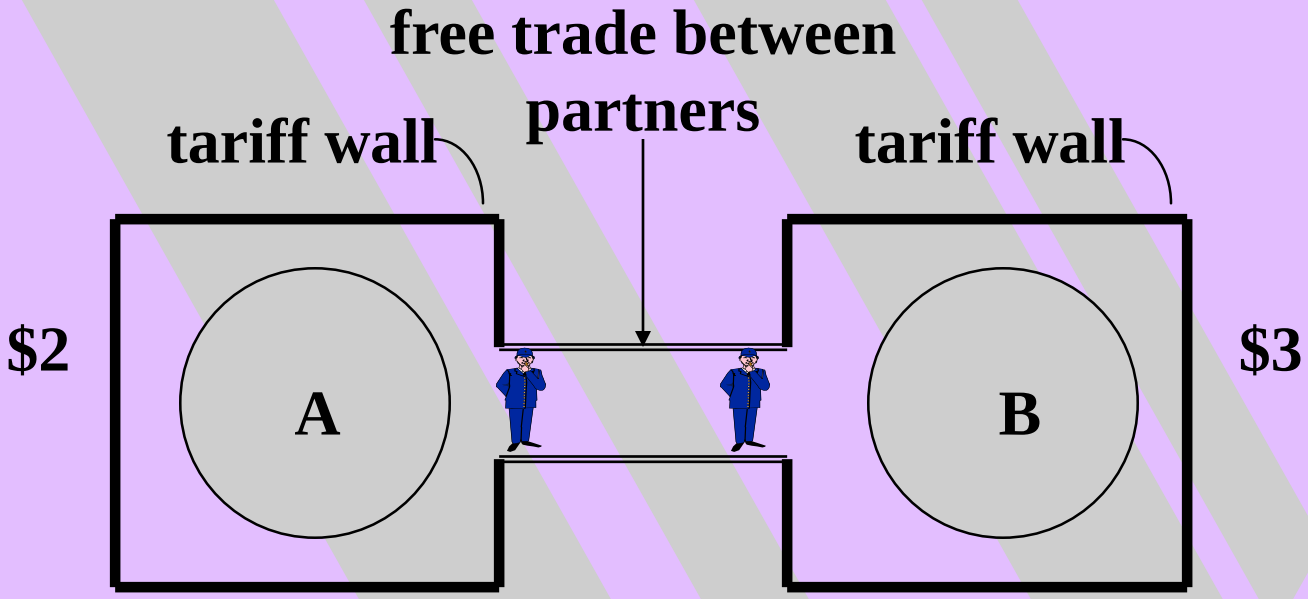
After area is formed, each country retains its own tariff wall against non-partner countries.

Free Trade Area



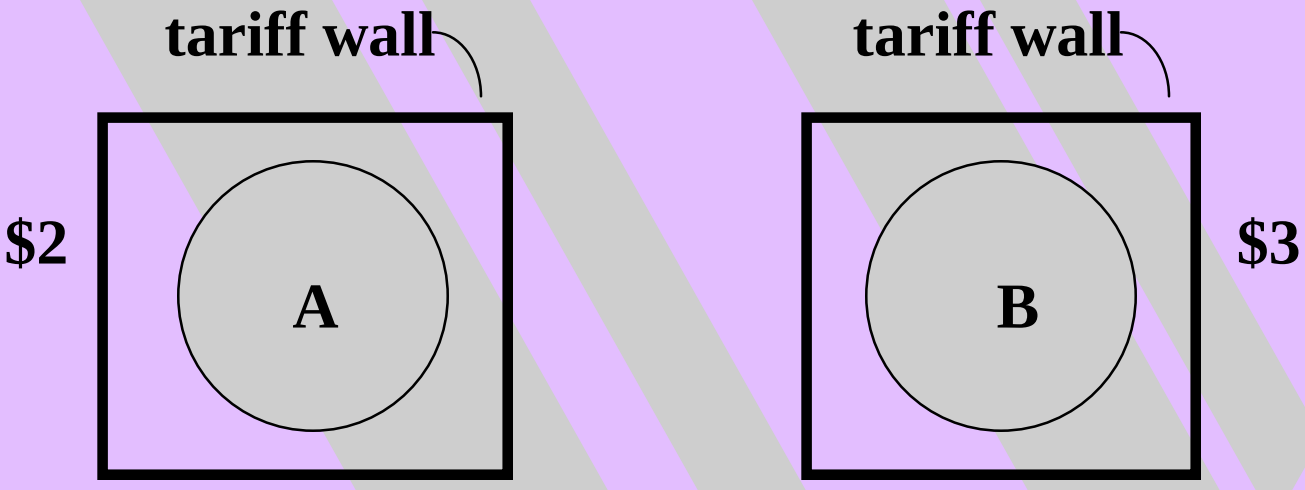
What does this arrangement imply about customs administration?

Free Trade Area



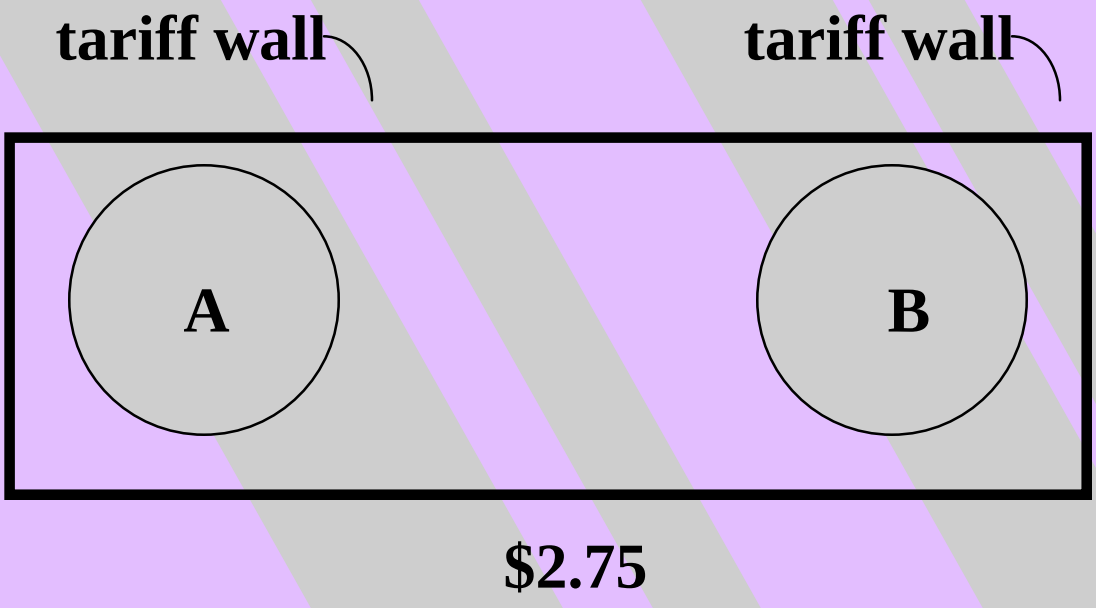
The price of maintaining individual sovereignty with regard to non-partners is customs administration for trade between A and B.

Customs Union



After area is formed, the two countries adopt a common tariff wall against non-partner countries.

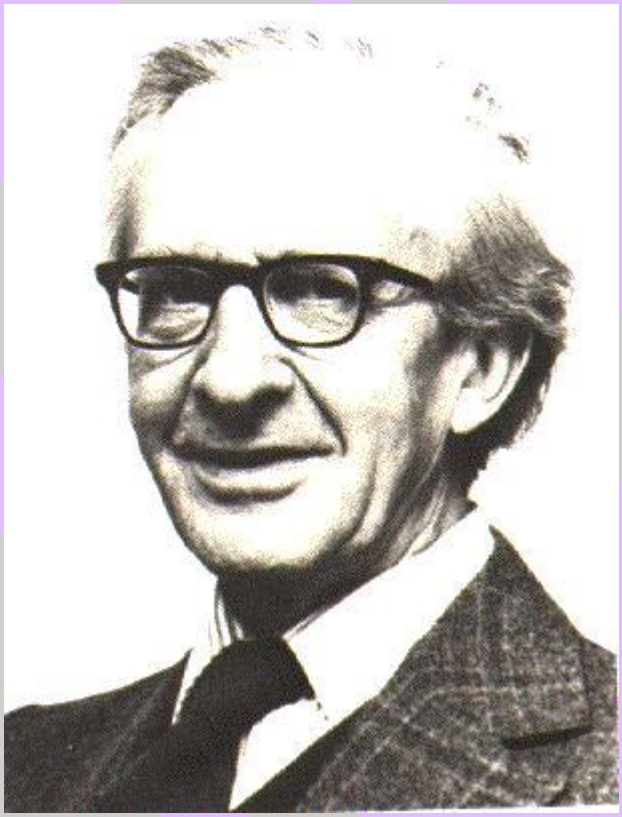
Customs Union



With a common tariff, there is no need for customs administrators to examine trade between A and B.

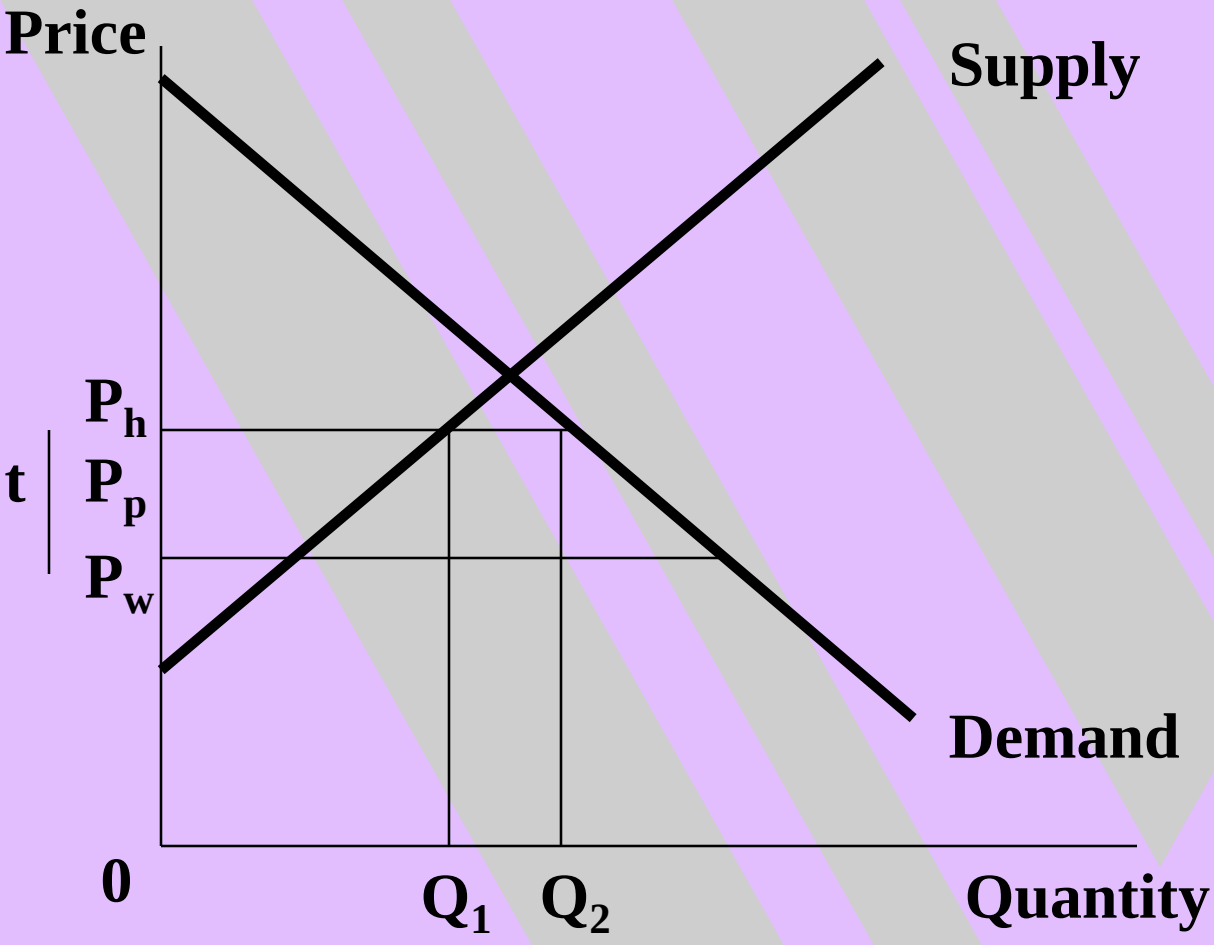
Analysis of Trade Integration

Jacob Viner
1892-1970



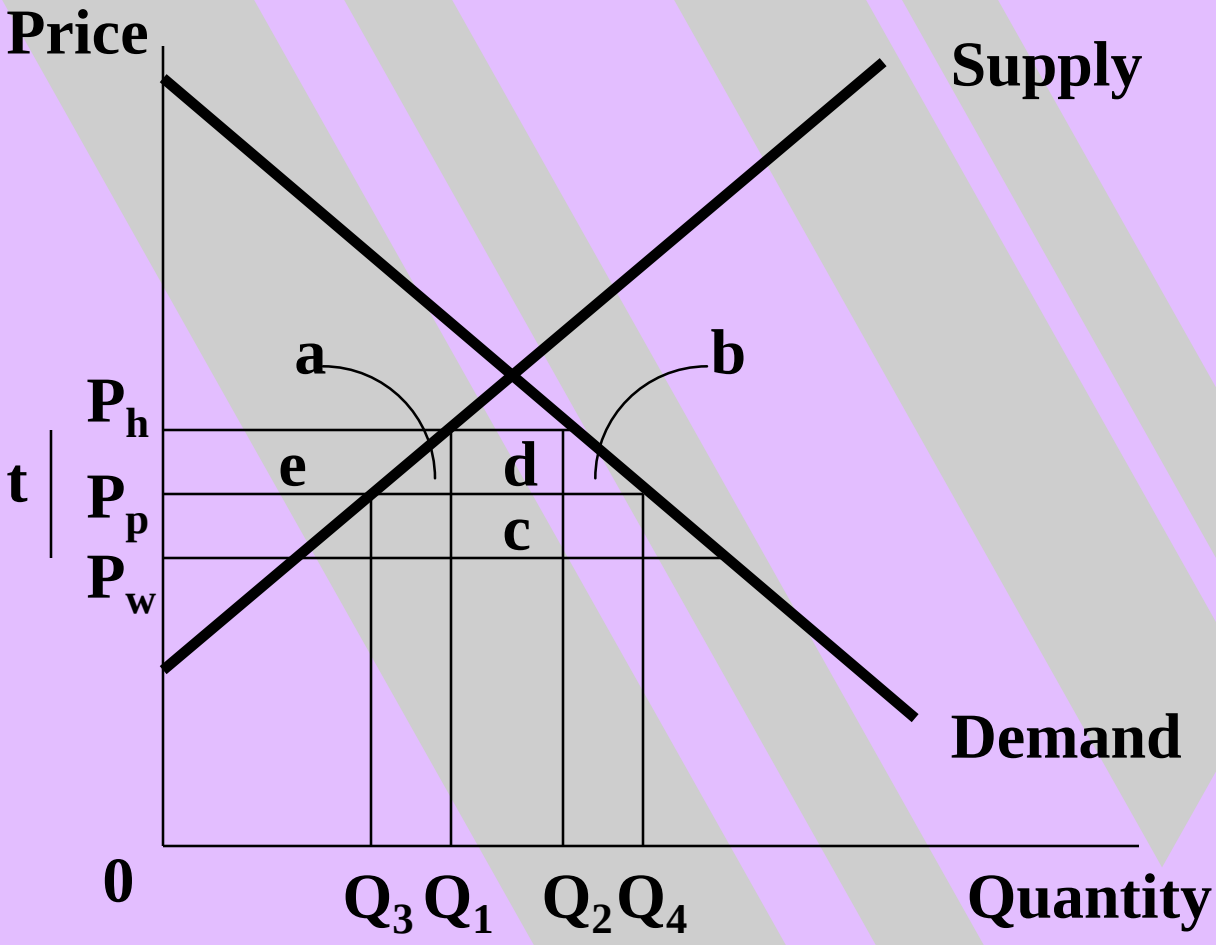
James E. Meade
1907-1996

Analysis of Trade Integration



The country forms an integration agreement with a partner producing at price $P_p < P_h$.

Analysis of Trade Integration



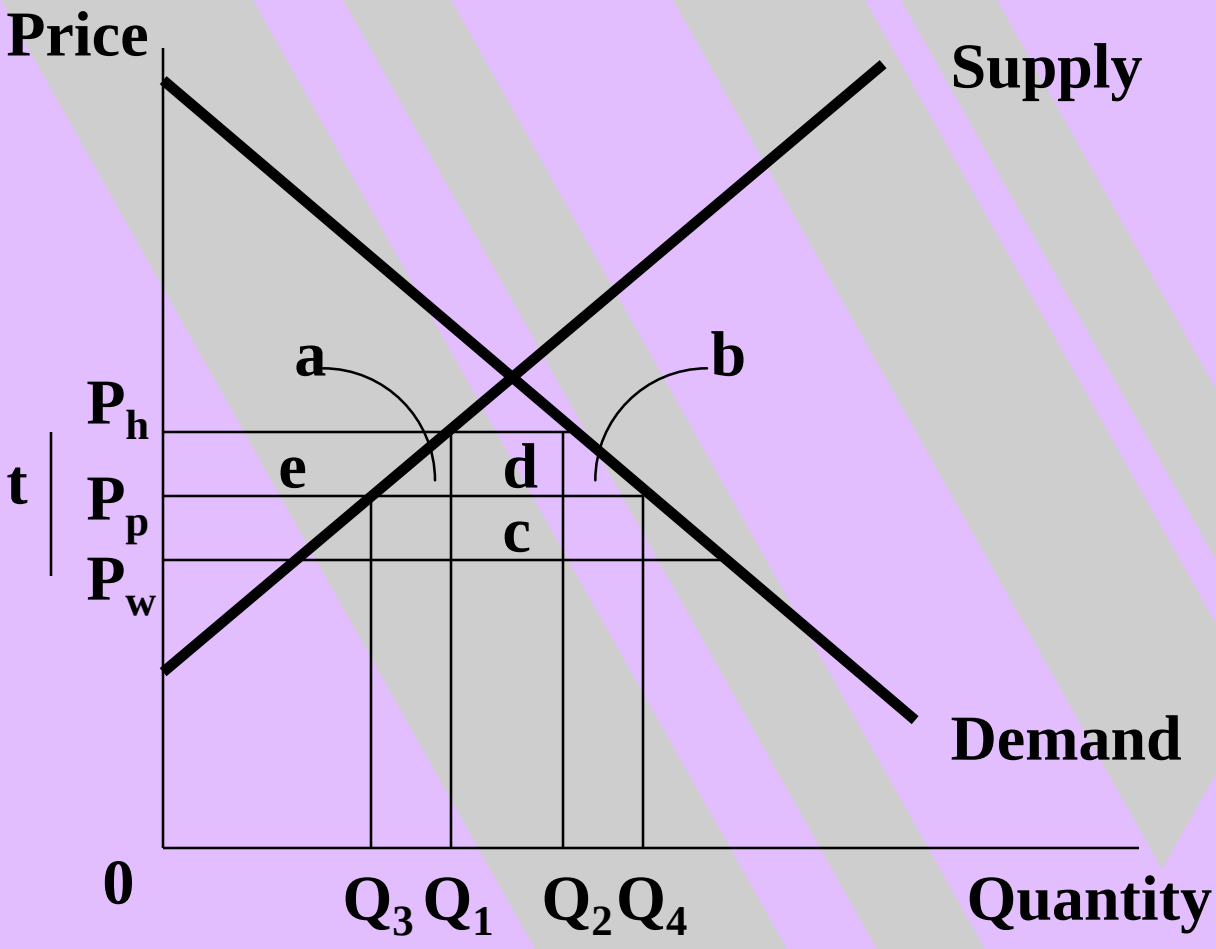
Consumers gain e+a+d+b

Producers lose “e”

Govt. loses d+c

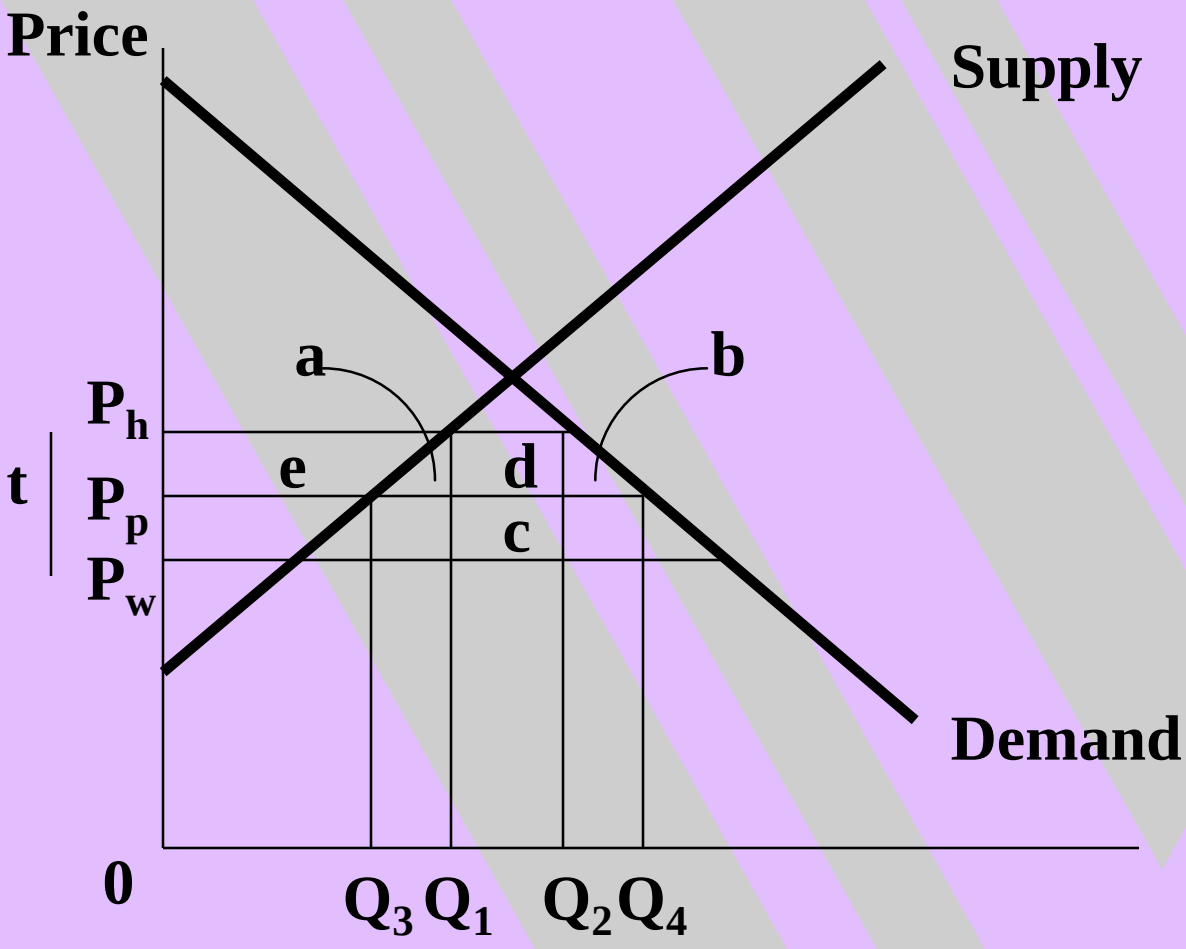
Net gain if a+b > c

Analysis of Trade Integration



- Imports expand from Q_1Q_2 to Q_3Q_4 (trade creation).
- Imports of Q_1Q_2 are diverted from low-cost world to high-cost partner (trade diversion).

Conditions to Maximize Trade Creation and Minimize Trade Diversion



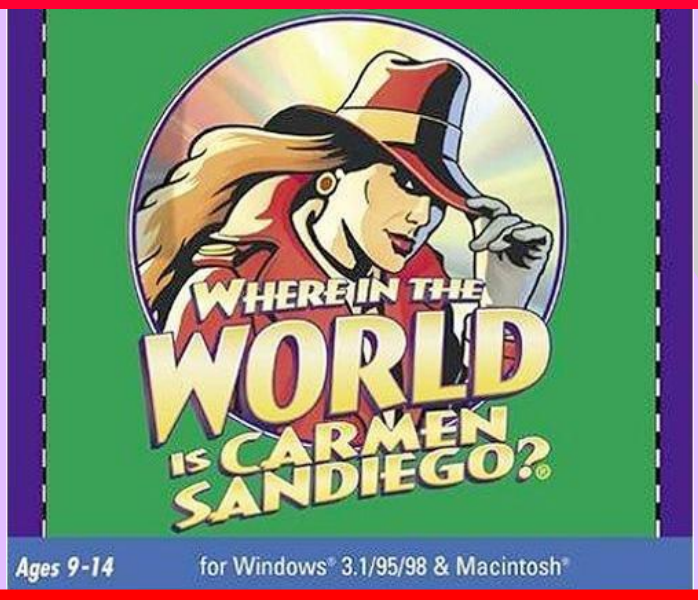
- **High elasticities of demand and supply (to increase the size of the triangles "a" and "b")**
- **Partner price close to world price (to decrease the rectangle "c")**

Other Considerations

- **Economies of scale**
- **Increased competition**
- **Political integration**

EU Headquarters Brussels

NAFTA Headquarters?



Dutch-German border marker at Glanerbrug, Holland

NAFTA involves trade and investment, not labor mobility

National Disintegration?

Los Angeles Times

Bush vetoes Democrats' Iraq war bill

Small turnout, big questions

Scotland may go its own way

Murdoch offers $5 billion for Wall St. Journal owner

Acrobat who died in fall lacked safety gear

* LE JOURNAL DE QUÉBEC, 21 janvier 2006, VA to

ON NE LAISSERA PAS CALGARY DÉCIDER POUR LE QUÉBEC

Seul le **Bloc Québécois** est une valeur sûre pour défendre véritablement les intérêts du Québec. On ne peut pas laisser le reste du Canada décider de ce qui est bon pour le Québec, comme ils ne nous laisseraient pas décider de ce qui est bon pour eux.

HEUREUSEMENT, ici, c'est le Bloc

Le 23 janvier, on vote!

BLOC QUÉBÉCOIS

PROJET DE LOI

SUR L'AVENIR

DU QUÉBEC

INCLUANT

LA DÉCLARATION DE SOUVERAINETÉ

ET L'ENTENTE DU 12 JUIN 1995

Québec

Demand/Supply Model: *Lessons*

- **Inefficiencies due to trade barriers affect production and consumption choice**
- **Tariffs create a wedge between the world and domestic price**
- **Quotas tend to isolate world and domestic prices**
- **Domestic monopoly interests will prefer quotas to tariffs**
- **The redistribution of income from quotas is uncertain (foreign vs. domestic)**

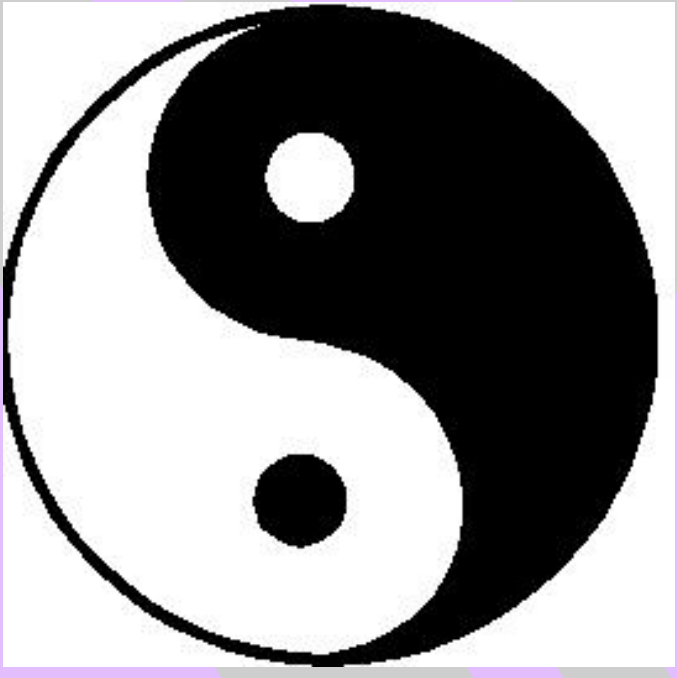
Demand/Supply Model: *More Lessons*

- Countries large enough can benefit from trade restrictions (terms of trade effect)
- Most other arguments for protection have hidden assumptions
- Net effect of trade integration can be positive or negative

Related Lessons

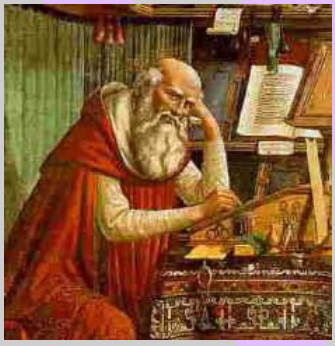
- **Average tariffs can be calculated simply by dividing tariff revenue by value of imports. But there are weighting problems entailed in that method.**
- **Effective tariffs measure the impact of nominal tariffs on economic activities.**
- **Dumping is a form of price discrimination in favor of the importing country.**

Could you work out a problem different from the import problems we have done in class?

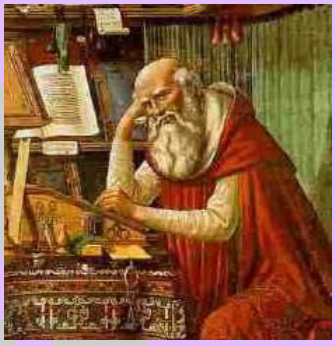


Exports rather than Imports?

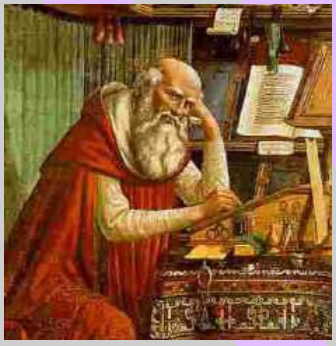
Subsidy rather than Tariff?



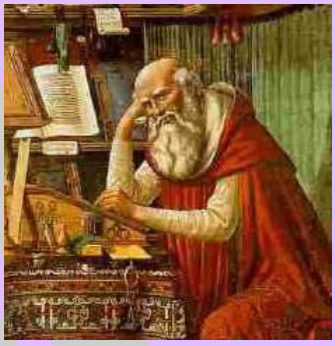
Problem



- Country exports 1,000,000 tons of a product
- It is very small in the market for this product. (Significance?)
- Its government decides to stimulate exports by giving <u>domestic producers of exports</u> a $1/ton subsidy for each ton exported
- Exports rise to 1,400,000 tons as a result of the subsidy
- *Task*: Calculate the resulting deadweight loss, if any, of imposing the subsidy.
- *Explain* why the underlined phrase might be important



Problem



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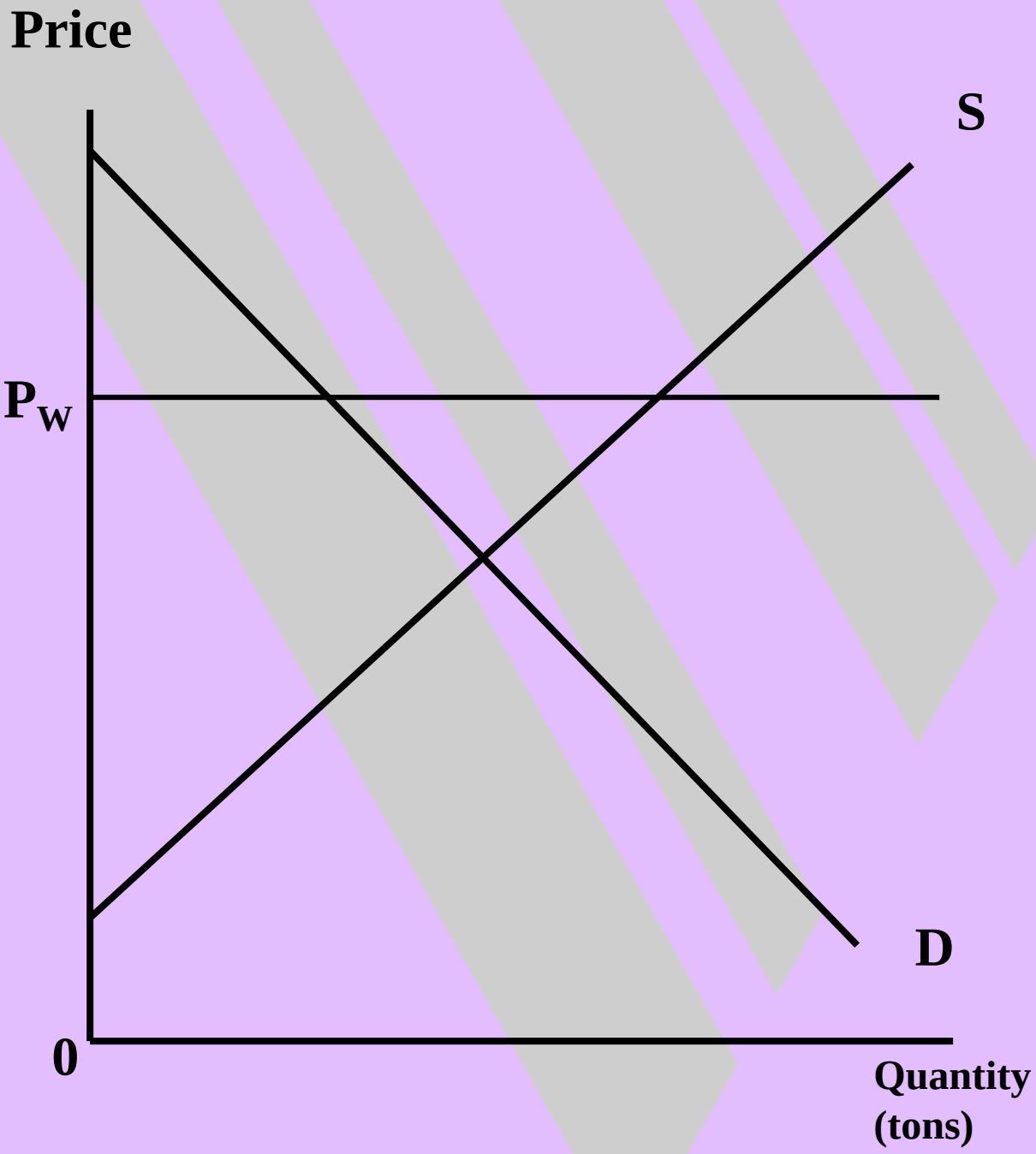
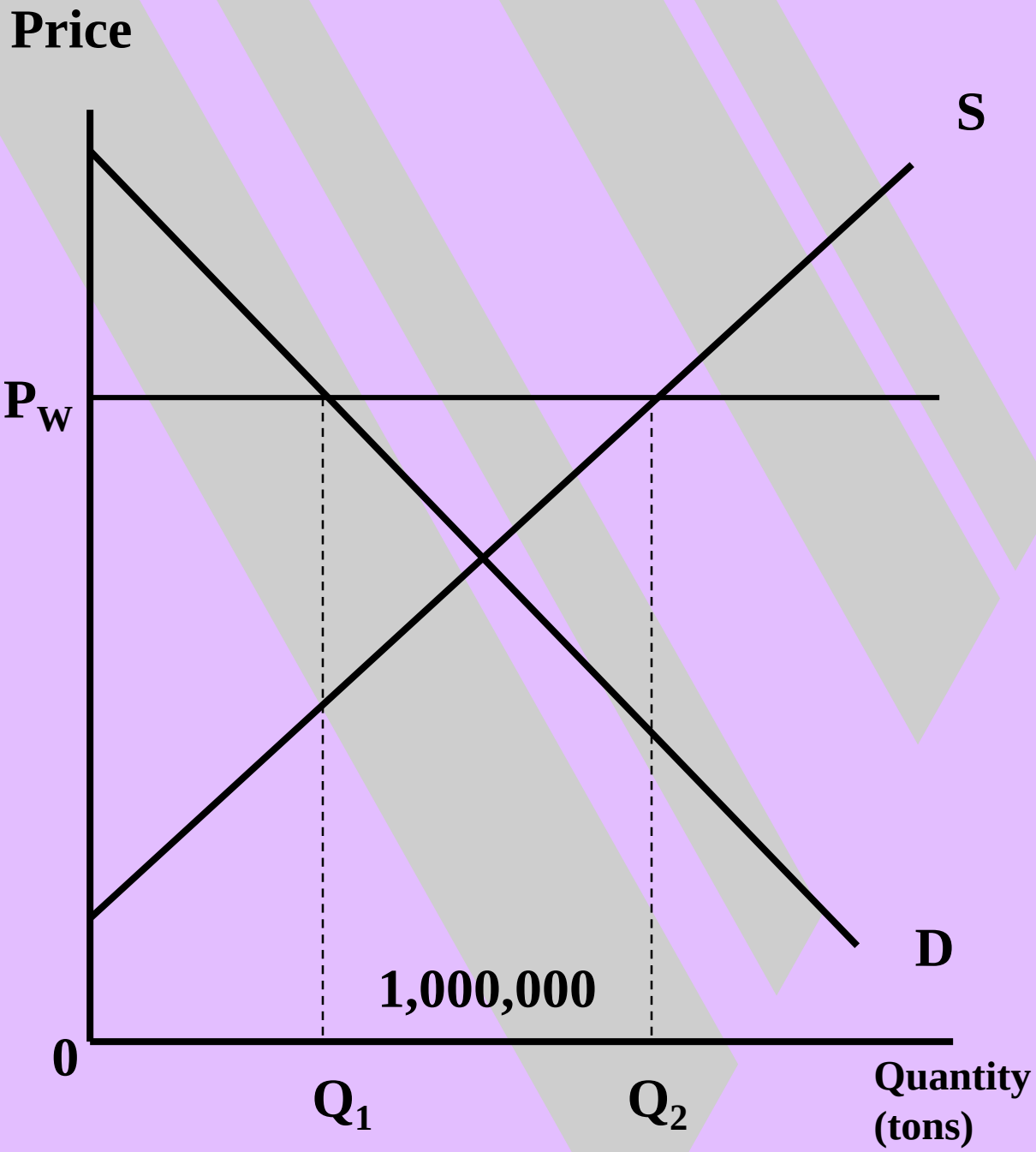
- Exports rise to 1,400,000 tons as a result of the subsidy
- *Task*: Calculate the resulting deadweight loss, if any, of imposing the subsidy.
- *Explain* why the underlined phrase might be important
- We will add the reasonable assumption that the govt. would follow policy to limit the cost to the treasury via an import embargo

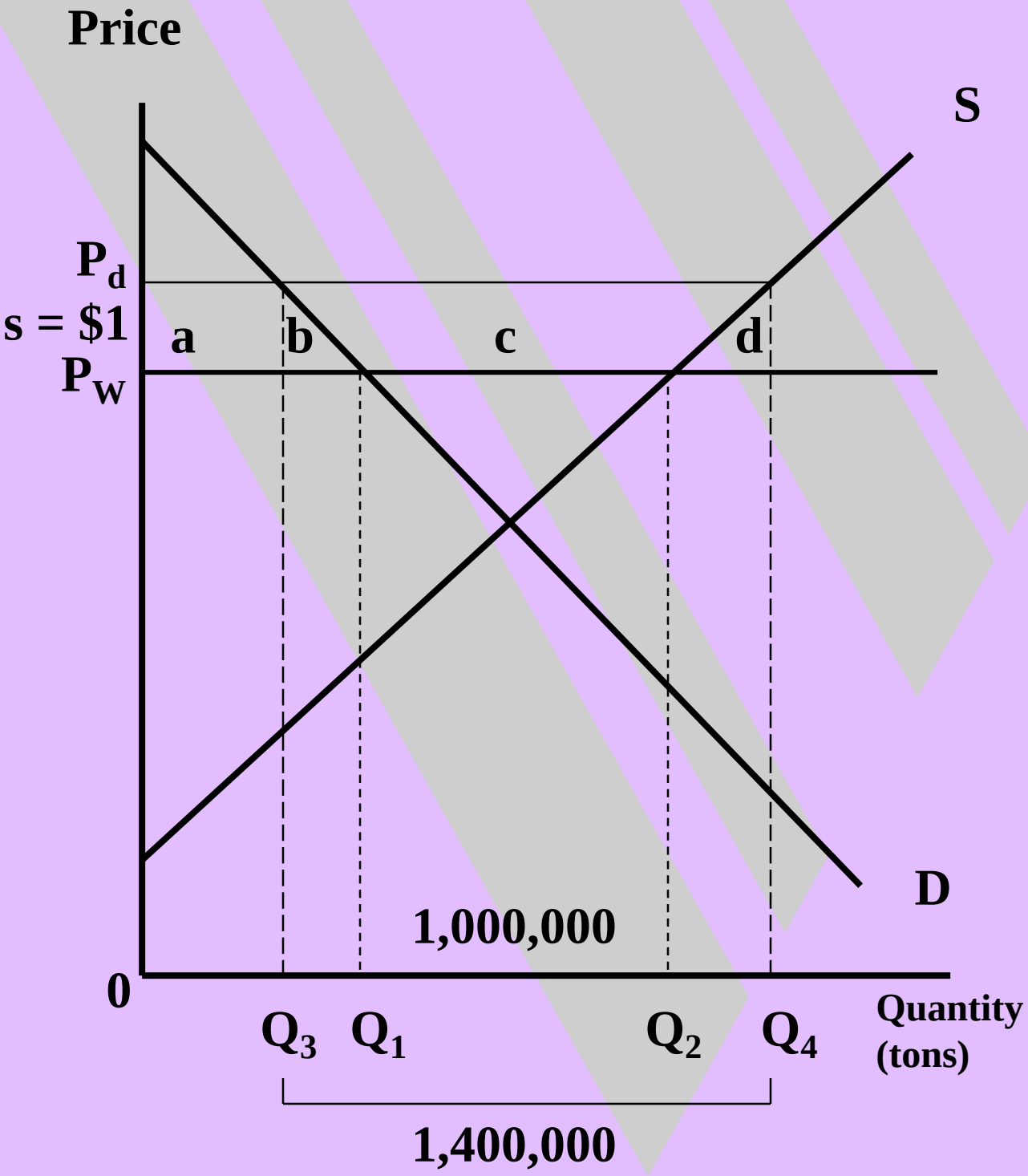
How do we depict an export?



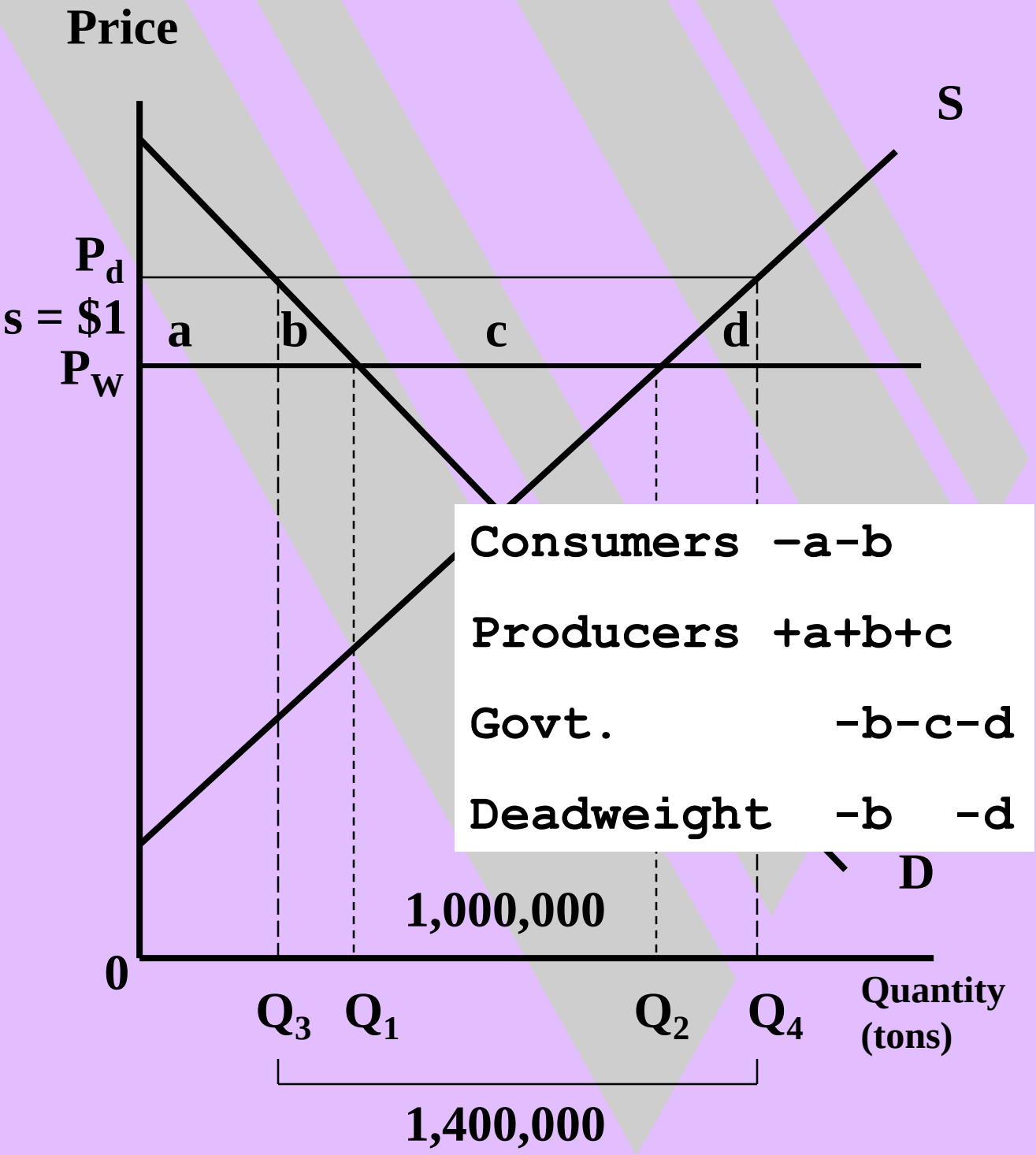
How do we depict an export?



How do we depict an export?

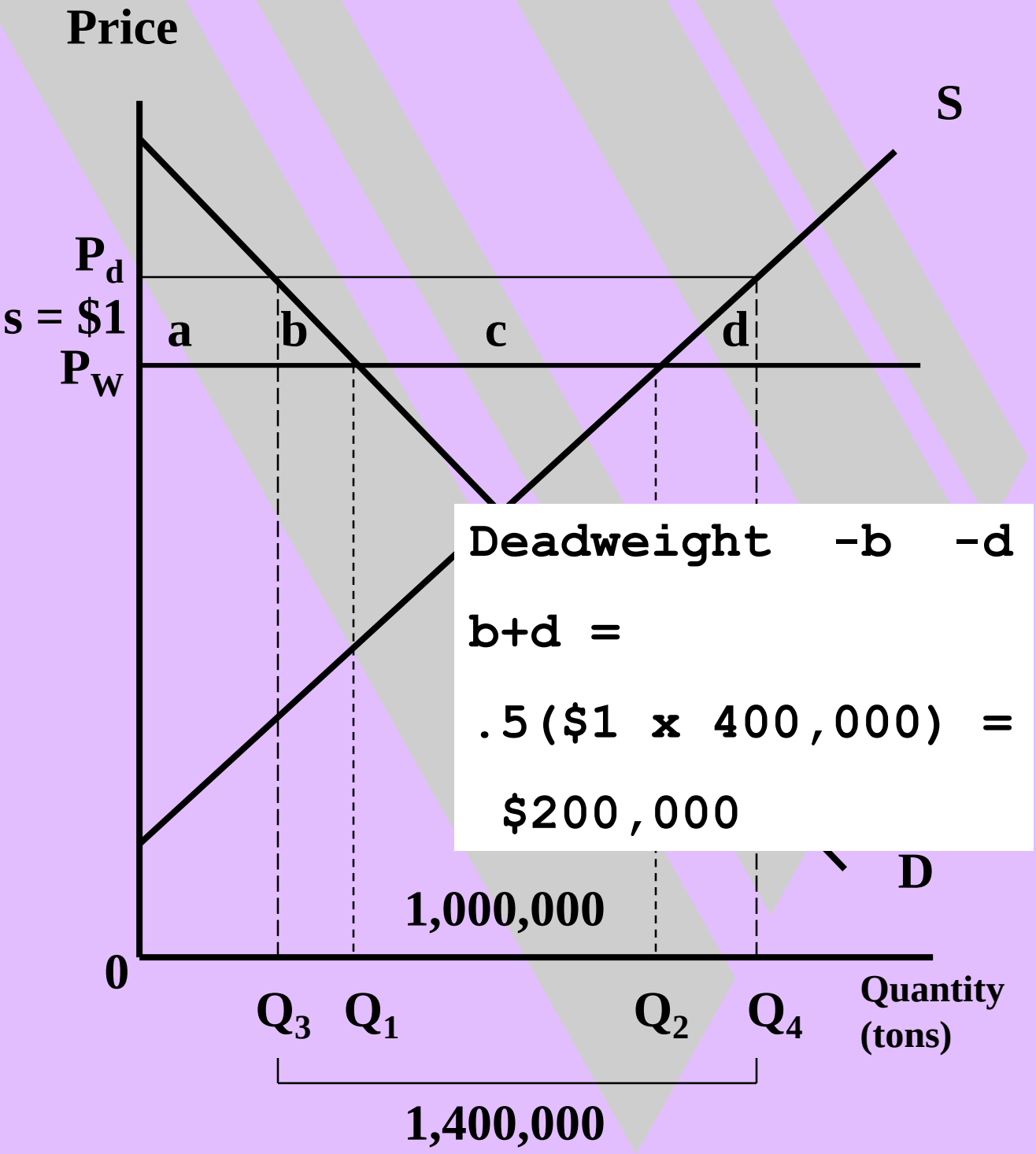


How do we depict an export?



Consumers	−a−b
Producers	+a+b+c
Govt.	−b−c−d
Deadweight	−b −d

How do we depict an export?

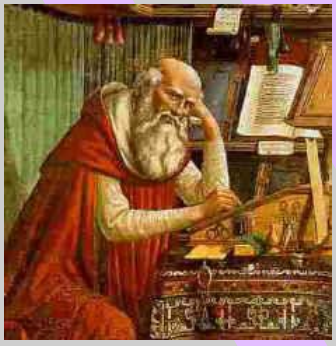


Deadweight -b -d

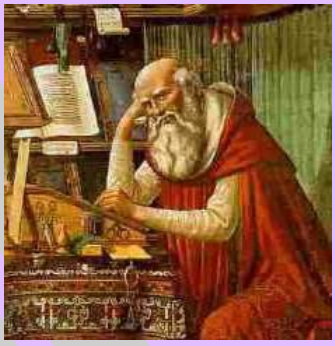
b+d =

.5($1 x 400,000) =

$200,000

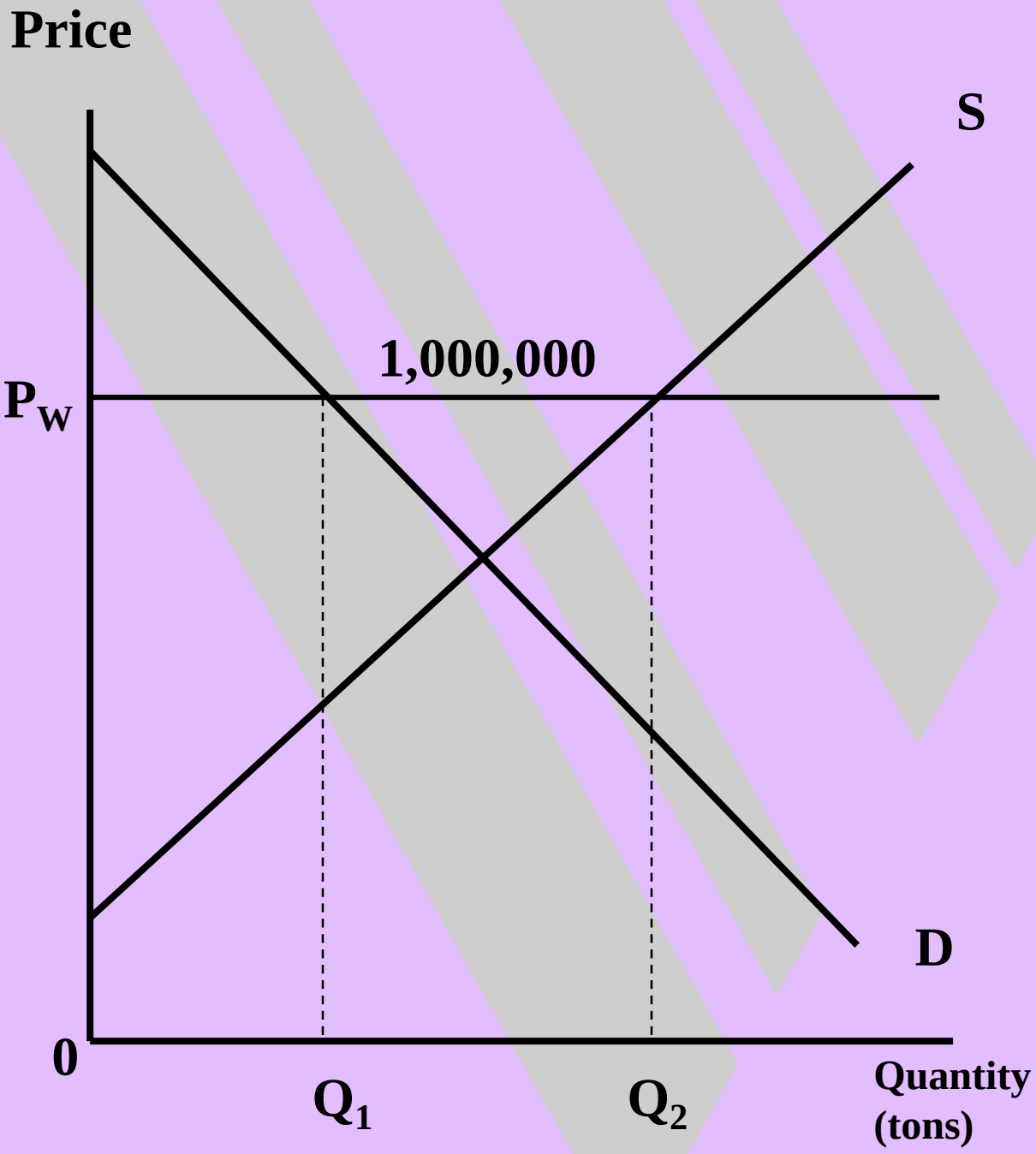


Problem

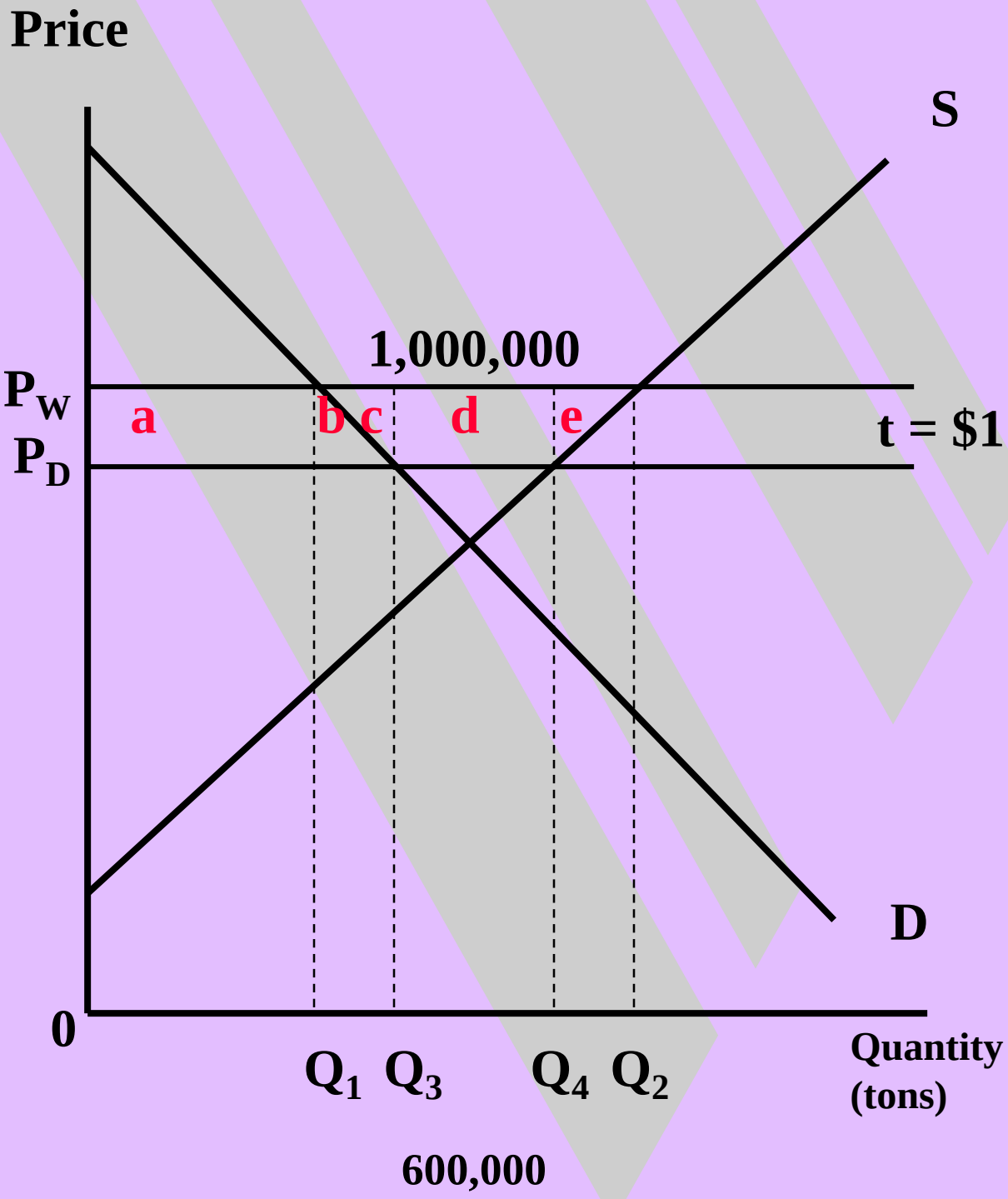


- Country exports 1,000,000 tons of a product
- It is very small in the market for this product. (Significance?)
- Its government decides to tax exports by imposing a tariff of $1 for each ton exported
- Exports change by 400,000 tons as a result of the tariff
- *Task*: Calculate the resulting deadweight loss, if any, of imposing the tariff.
- *What is the direction of the underlined change?*

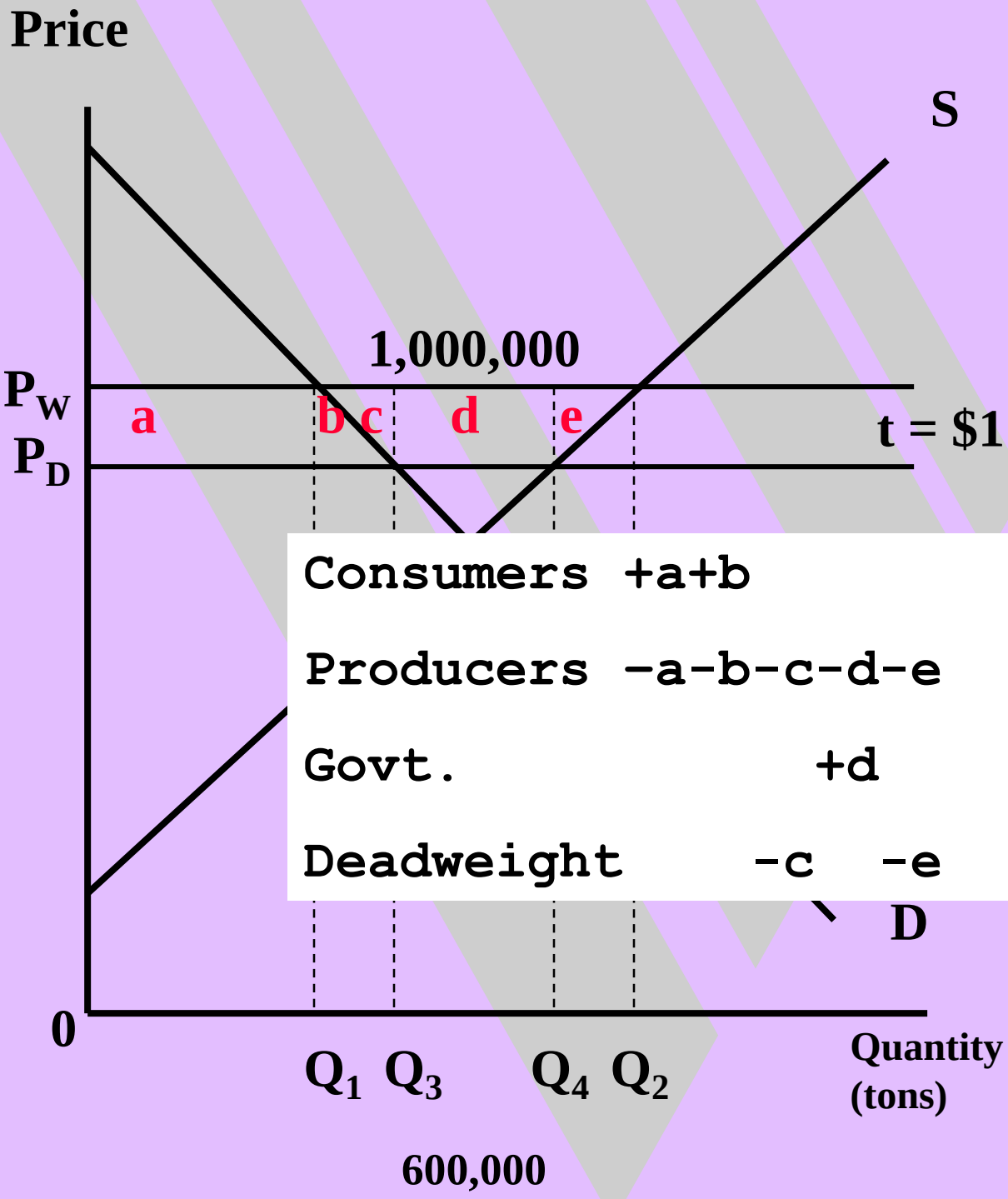
How do we depict an export?



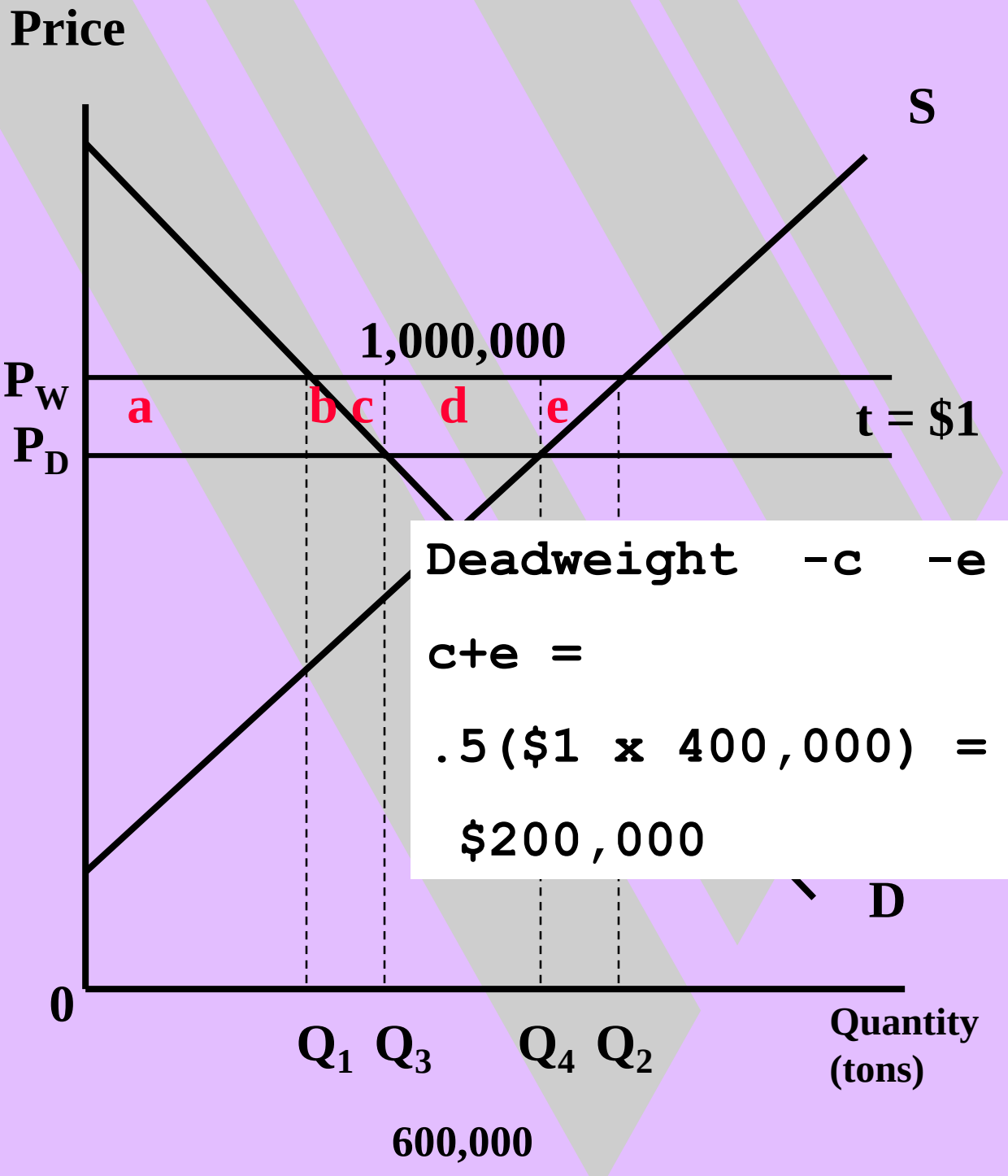
Impose the tariff (t)



Impose the tariff (t)



Impose the tariff (t)

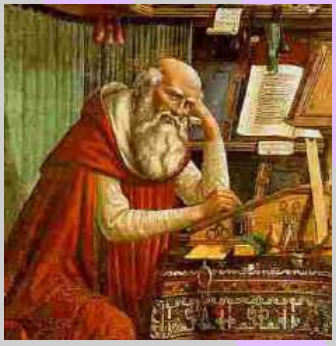


Deadweight -c -e

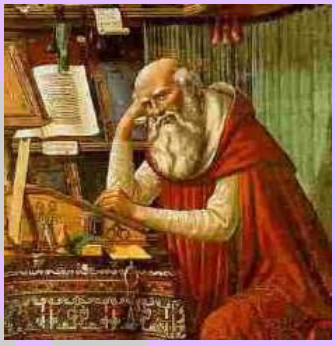
c+e =

.5($1 x 400,000) =

$200,000

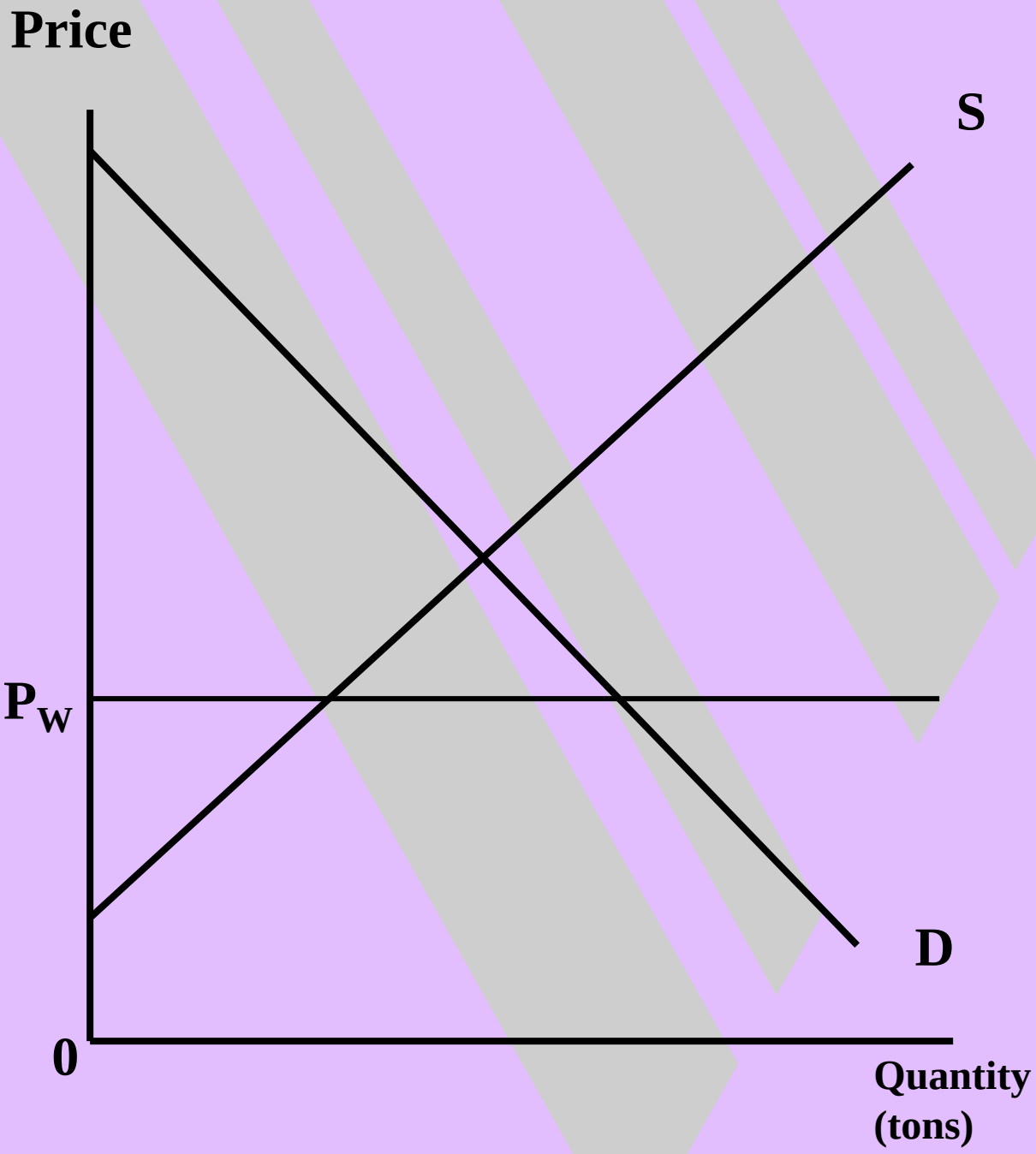


Problem

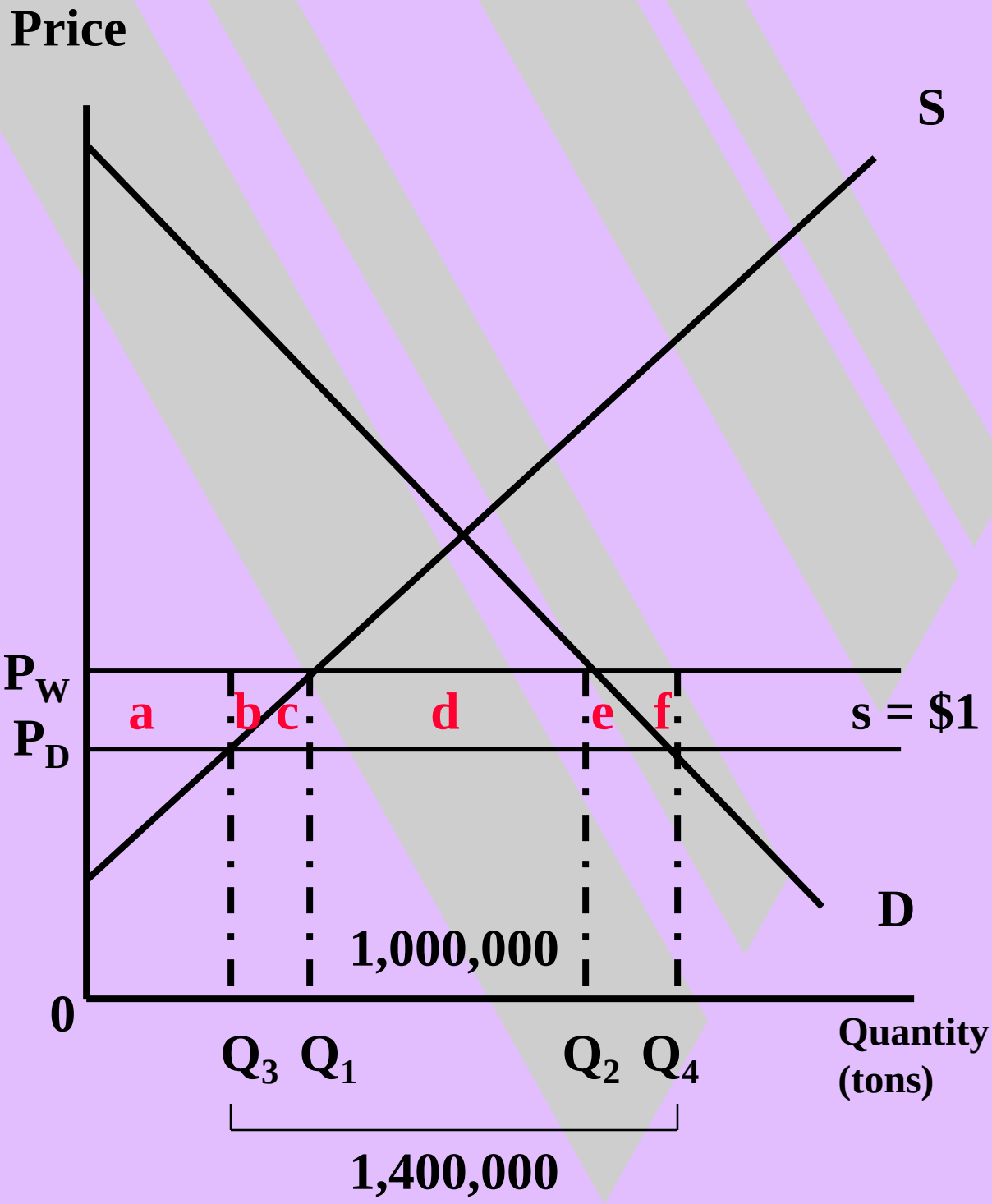


- Country imports 1,000,000 tons of a product
- It is very small in the market for this product. (Significance?)
- Its government decides subsidize imports by offering a subsidy of $1 for each ton imported. It also bans exports of this product. (Why?)
- Imports change by 400,000 tons as a result of the subsidy
- *Task*: Calculate the resulting deadweight loss, if any, of imposing the subsidy.
- *What is the direction of the underlined change?*

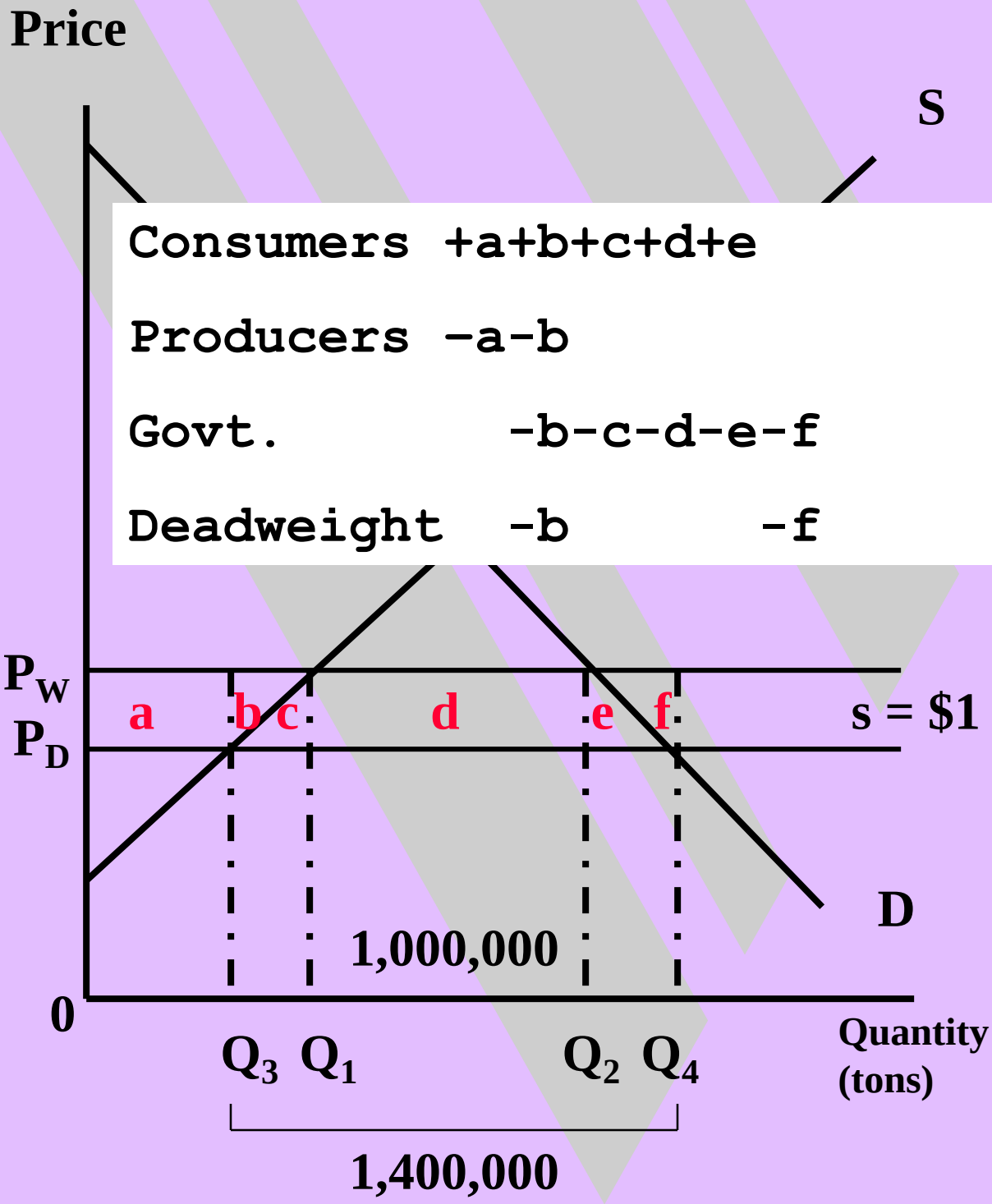
How do we depict an import?



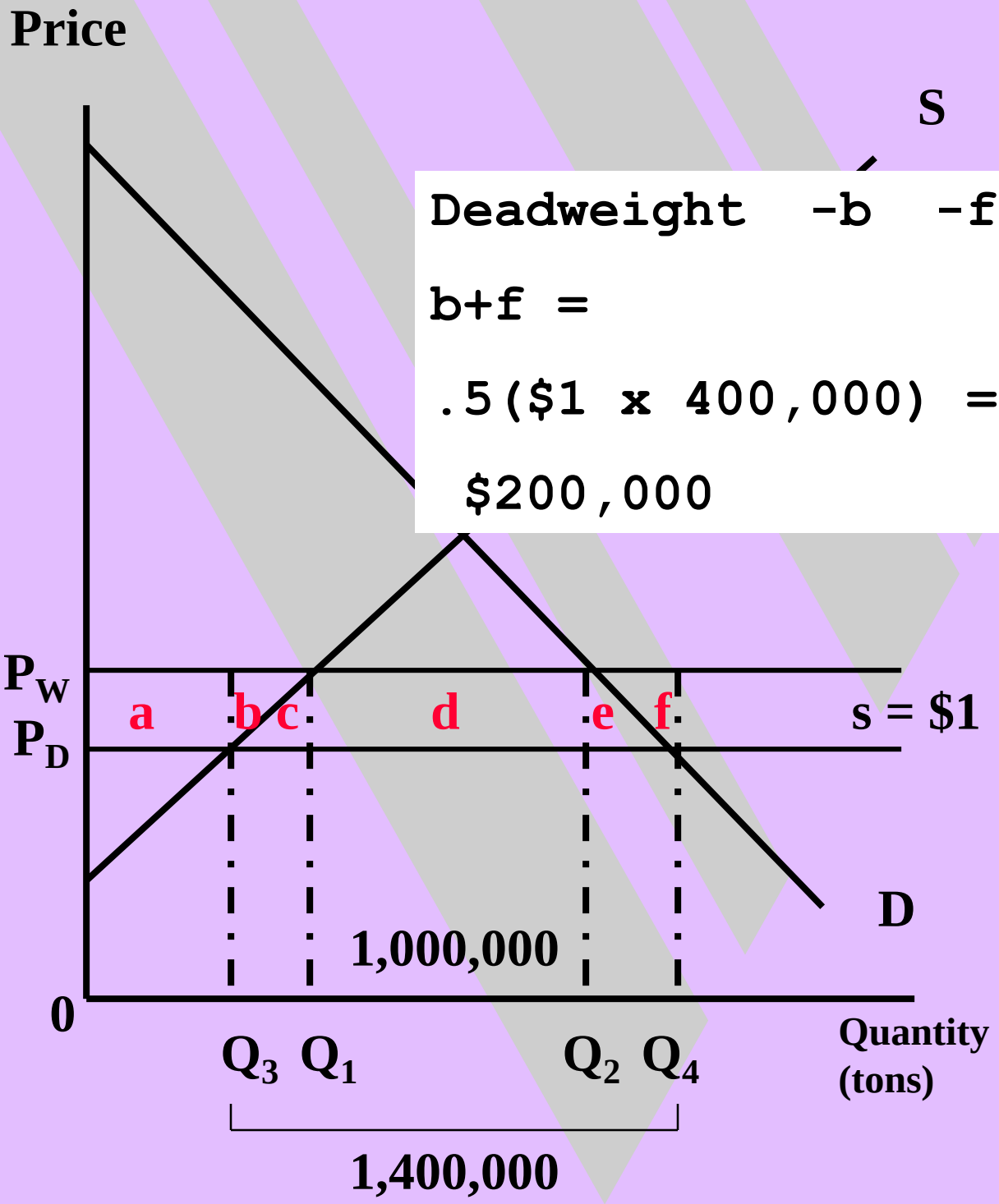
How do we depict an import?



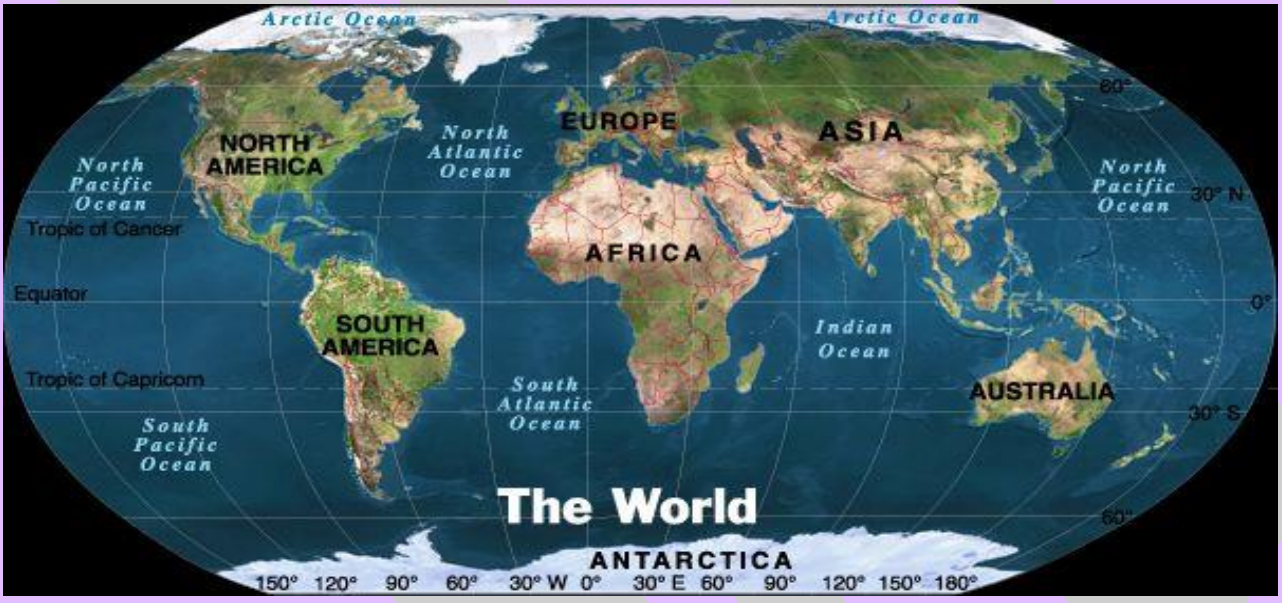
How do we depict an import?



How do we depict an import?



MGT. 205A



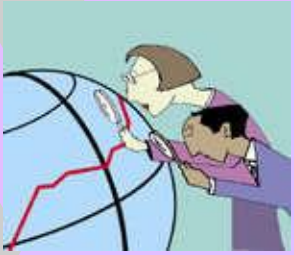
Daniel J.B. Mitchell

Ho-su Wu Professor

Anderson School

and

School of Public Affairs



MGT. 205A

Part II

Value = Price x Quantity

Price

Exchange rate

Domestic price level

Quantity

Business cycle

Macro policy

Value

Balance of payments

MGT. 205A

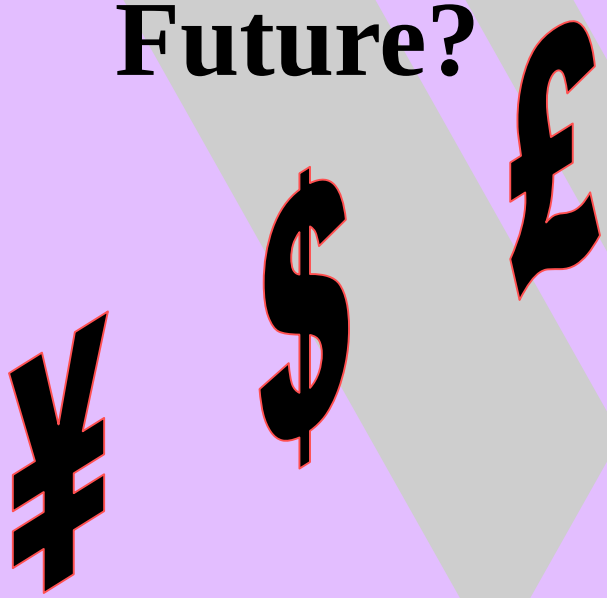
Part II

International Monetary System

How did it evolve?

Current situation

Future?



IMF Currencies

Argentine Peso

Australian Dollar

Bahrain Dinar

Botswana Pula

Brazilian Real

Brunei Dollar

Canadian Dollar

Chilean Peso

Chinese Yuan

Colombian Peso

Cyprus Pound

Czech Koruna

Danish Krone

E.U. Euro

Hungarian Forint

Icelandic Krona

Indian Rupee

Indonesian Rupiah

Iranian Rial

Israeli New Shekel

IMF Currencies

Japanese Yen

Kazakhstani Tenge

Korean Won

Kuwaiti Dinar

Libyan Dinar

Malaysian Ringgit

Maltese Lira

Mauritian Rupee

Mexican Peso

Nepalese Rupee

New Zealand Dollar

Norwegian Krone

Rial Omani

Pakistani Rupee

Polish Zloty

Qatar Riyal

Russian Ruble

Saudi Arabian Riyal

Singapore Dollar

Slovak Koruna

IMF Currencies

South African Rand

Sri Lanka Rupee

Swedish Krona

Swiss Franc

Thai Baht

Trinidad And Tobago Dollar

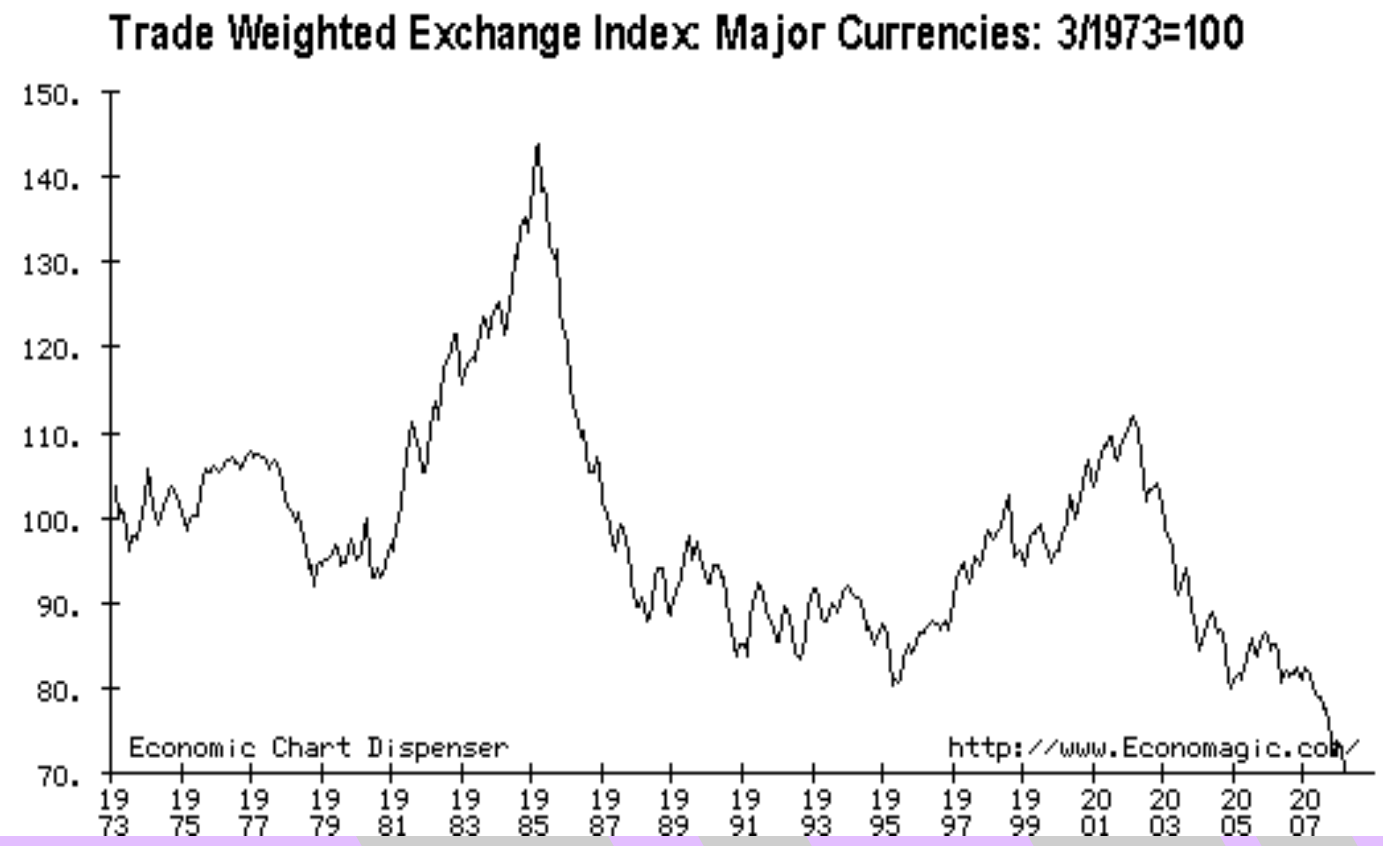
U.A.E. Dirham

U.K. Pound Sterling

U.S. Dollar

Venezuelan Bolivar Fuerte

And don't forget: Hong Kong Dollar and the Taiwan Dollar


Trade Weighted Exchange Index Major Currencies: 3/1973=100
150.
140.
130.
120.
110.
100.
90.
80.
70.
Economic Chart Dispenser
http://www.Economagic.com/
19 73
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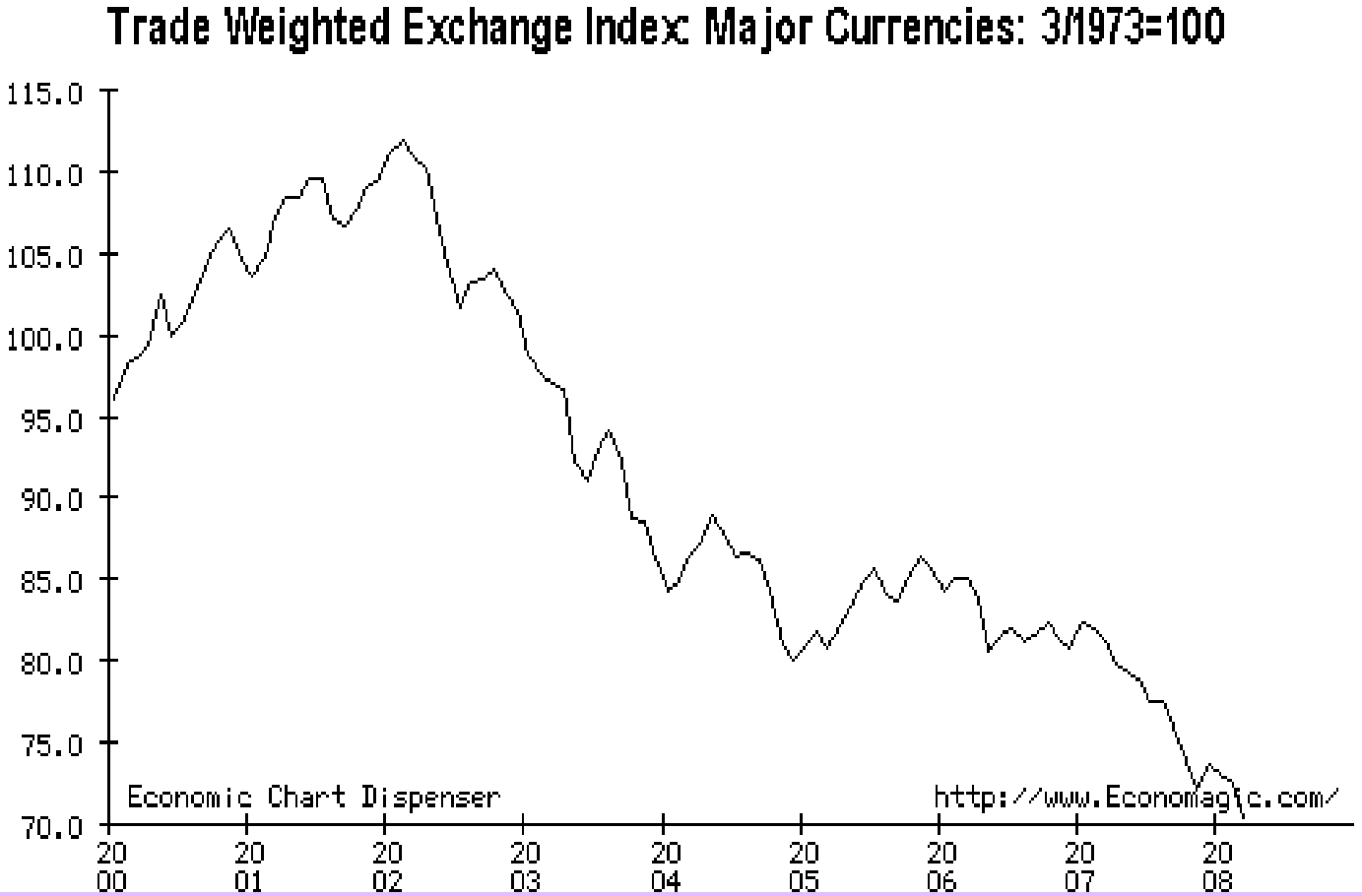
Trade Weighted Exchange Index Major Currencies: 3/1973=100
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75.0
70.0
Economic Chart Dispenser
http://www.Economagic.com/
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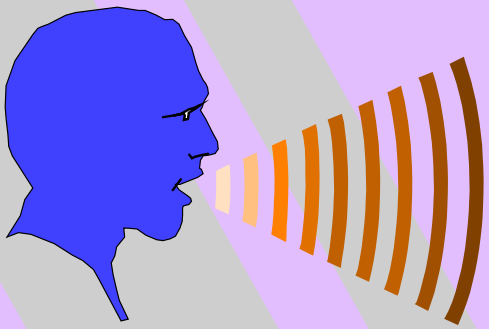


Basic Exchange Rate Terminology

Devaluation (Depreciation) of $

Before: $1 = 10 talents

or: T1 = 10¢

After: $1 = 8 talents

or: T1 = 12.5¢

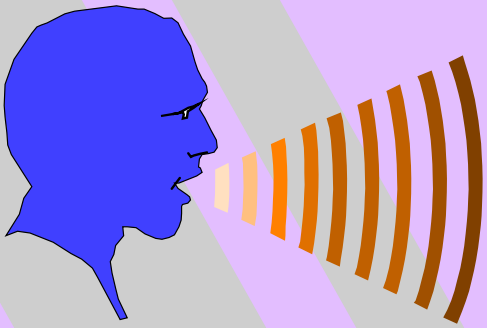
Revaluation (Appreciation) of $

Before: $1 = 10 talents

or: T1 = 10¢

After: $1 = 12 talents

or: T1 = 8.333...¢



Basic Exchange Rate Terminology

$

Devaluation tends to connote a government policy action

Depreciation tends to connote a market development

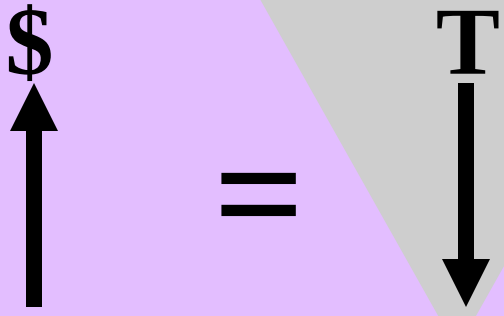
Revaluation tends to connote a government policy action

Appreciation tends to connote a market development

$

Interdependence of Policy

Dollar devaluation or depreciation implies talent revaluation or appreciation.

Talent devaluation or depreciation implies dollar revaluation or appreciation.

Both currencies cannot move (or be made to move) in the same direction.